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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

EVALUATION REPORT

JOBZ Program

FEBRUARY 2008

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OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

February 2008

Members of the Legislative Audit Commission:

Since January 2004, the JOBZ program has attempted to stimulate economic development in Greater Minnesota by allowing local governments to provide reductions in state and local taxes to businesses willing to locate or expand in designated zones. In its first three years of operation, local governments signed more than 300 subsidy agreements with businesses, and the program has provided businesses with more than $45 million in tax breaks.

We found that JOBZ has been used appropriately in some cases and helped create jobs. But we also found significant problems with the program's design and implementation, resulting in some cases of ineffective and inappropriate use of tax subsidies. We make recommendations that would focus the program and improve its administration.

This report was researched and written by John Yunker (project manager) and David Kirchner. Bryan Dahl also provided valuable research assistance. The Department of Employment and Economic Development, the Department of Revenue, and various local governments cooperated fully with our evaluation.

Sincerely,

James Nobles
Legislative Auditor

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- However, the program has not been focused on those goals and has been used to provide tax breaks to some businesses that would have expanded in Greater Minnesota without JOBZ (p. 93).
- In addition, the program has subsidized some businesses that compete with existing Minnesota businesses for the same Minnesota customers (p. 93).
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- Some businesses removed from the JOBZ program have not had to repay any property tax breaks and have continued to receive those subsidies for a time following their removal from the program (pp. 63-64).

Recommendations:

- The Legislature should require DEED to review and approve all business subsidy agreements before they can become effective. DEED should also be required to implement meaningful criteria for determining whether a business should receive JOBZ assistance (pp. 59-60, 98, and 101).
- The Legislature should either limit the number of businesses allowed to enter the JOBZ program each year or limit the estimated cost of future subsidies for new entrants each year (pp. 98-99).
- DEED should revamp the reporting forms used to monitor compliance and measure the overall effectiveness of the program (pp. 71-72).
- DEED should streamline its compliance process to more rapidly identify and remove from the program businesses that do not meet their obligations (p. 70).

Report Summary

The JOBZ (Job Opportunity Building Zones) program attempts to spur economic growth in Greater Minnesota by providing state and local tax breaks to selected businesses. To qualify for the program, a business must locate in one of the designated zones throughout Greater Minnesota and sign a business subsidy agreement with its local jurisdiction.

After the program's introduction in 2004, it quickly became one of Minnesota's most utilized economic development programs. More than 150 local communities and 350 businesses have participated in the program.

The JOBZ program has not provided much help to certain economically distressed areas in Greater Minnesota.

The JOBZ program has not been targeted to economically distressed areas within Greater Minnesota.

Typically, enterprise zone programs have been used across the nation to provide tax breaks to businesses locating in economically distressed parts of a state or city. Similarly, state law required the Department of Employment and Economic Development (DEED) to use various need and success criteria in establishing ten JOBZ zones across the state.

But these criteria became unimportant because DEED worked with local governments to ensure that there were only ten applications. Each of these applications included dozens of cities and townships and hundreds of noncontiguous subzones.

As a result, there has been no targeting of JOBZ incentives to areas with greater distress except to limit the program to Greater Minnesota. DEED has established over 1,150 separate subzones on a total of about 29,300 acres in more than 350 cities and townships. DEED has also frequently moved the subzones to accommodate the location preferences of interested businesses.

The JOBZ program provides a useful economic development tool, but it has been used at times to provide unnecessary subsidies.

JOBZ has some value as an economic development tool. It has been successful in attracting some businesses to Minnesota from other states and in keeping some business expansions from leaving the state. However, the program has not maintained a focus on these goals.

Surveys of JOBZ businesses indicate that about 19 percent of the participants would have expanded to the same extent in Greater Minnesota without JOBZ assistance. In addition, another 50 percent would have expanded to some extent without tax breaks.

Furthermore, local governments have approved JOBZ subsidies for businesses that compete with other Greater Minnesota companies for the same Minnesota customers. The increase in employment at subsidized businesses could be offset by job cuts at their competitors.

Finally, the program sometimes provides subsidies to businesses that do not need the full array of JOBZ subsidies in order to expand. The program lacks any procedures to determine whether less generous subsidies than those offered by JOBZ would be sufficient to induce a business to expand in Greater Minnesota.

The program's effectiveness is reduced by the lack of a statewide perspective in the approval of JOBZ deals and the absence of any budgetary constraints.

Local governments make decisions about business participation with little state input and no significant budget constraints.

Local governments, not state agencies, determine what job growth and capital investment obligations companies must meet to participate in the program. The JOBZ law sets some minimum requirements but only for companies that relocate part or all of their operations into a zone from another Minnesota location.

Local officials evaluate potential JOBZ companies primarily on their likely effect on the local economy and not on the broader impact on Greater Minnesota. Furthermore, local officials do not consider the full cost of providing JOBZ subsidies, since most of the tax breaks are funded by state government. Some cities find it hard to turn down requests from local businesses for JOBZ assistance and sometimes feel obligated to offer it in order to compete with other Minnesota communities.

The number of businesses in the program is limited only by the amount of land that can be designated as JOBZ locations. The JOBZ legislation authorizes DEED to designate up to 50,000 acres statewide as JOBZ sites. This has not proved to be a meaningful limit on program participation. Essentially, any business that meets the minimal statutory requirements may participate if approved by a local government.

As a result, JOBZ is not focused on those businesses likely to contribute to substantial economic growth in Greater Minnesota. In addition, nearly half of the businesses participating in JOBZ are obligated to hire 5 or fewer new full-time equivalent employees.

The estimates published by the Department of Employment and Economic Development overstate the impact of the JOBZ program.

In statistics posted on its web site, DEED has credited the JOBZ program with the creation of 5,459 new full-time jobs as of the end of 2006. However, our review of unemployment insurance records suggests that the increase in employment at JOBZ businesses is at least 20 percent lower. The difference is due to the lack of adequate reporting forms and a tendency of businesses to overstate their employment.

Additionally, DEED's figures assume that none of the businesses in the JOBZ program would have created any new jobs in Greater Minnesota without the tax breaks provided by the program. However, as indicated above, surveys of JOBZ businesses indicate that a substantial number of them would have expanded to some extent even without JOBZ. In addition, economic studies of enterprise zone and tax incentive programs elsewhere in the country also suggest that DEED's estimates of economic impact are inflated.

The administration of JOBZ needs significant improvement.

There are significant problems with the business subsidy agreements signed by local governments.

To enter the JOBZ program, companies must sign business subsidy agreements with local governments in which they agree to meet employment and capital investment targets as a condition of receiving the subsidy. Nearly all of these agreements have contained ambiguous language, requiring businesses to create or retain full-time employees without providing a clear definition of “full-time” or “employee.”

Many agreements have been poorly worded and are dotted with grammatical inconsistencies that obscure the obligations of the participating companies. A few agreements set no deadlines for companies to meet their hiring commitments. Over 60 agreements do not require businesses to maintain the jobs they promise to create for as long as they are receiving tax breaks.

DEED’s process for reviewing JOBZ compliance is slow, inefficient, and may fail to identify some businesses that are not meeting their obligations.

Businesses and local governments that have entered JOBZ agreements must file reports with DEED every spring. However, DEED’s review of these reports has been slow. It took until February 2007 for the agency to determine that some businesses had not met their obligations during 2005. At the writing of this report, DEED had not completed reviewing and following up on reports filed for calendar year 2006.

DEED’s slowness in monitoring compliance has enabled a few businesses to receive property tax exemptions beyond the date that they became noncompliant with their business subsidy agreements. A speedier compliance process and a change in state law would address this problem.

In addition, the compliance process may fail to identify some businesses that are noncompliant. The process used by DEED to collect information on employment and wages is based on a flawed form. In addition, DEED does not require business officials to certify the accuracy of the information provided in annual progress reports. Although the information frequently conflicts with data that JOBZ businesses have submitted in their unemployment insurance filings, DEED staff have not used the unemployment insurance data to assist in monitoring compliance.

Introduction

In 2003, the Legislature enacted the Job Opportunity Building Zones (JOBZ) program. The program attempts to promote economic development in Greater Minnesota by providing state and local tax breaks to qualified businesses that expand, start up, or relocate within a tax exemption zone.[1] The tax breaks can be quite significant and are scheduled to last through the end of 2015. They include reductions to or exemptions from property, sales, corporate franchise, and individual income taxes. A refundable jobs credit is also available.

The JOBZ program attempts to promote economic growth by providing tax breaks to certain businesses in Greater Minnesota.

Supporters of the program believe that JOBZ has been very helpful in creating jobs in Greater Minnesota. They also feel that the program has attracted development that would have gone to neighboring states. Supporters say that some counties in Greater Minnesota have suffered significant declines in population and diminishing economic prospects over the last several decades. For them, JOBZ has provided the tools to attract development, create jobs, and retain population in those areas.

Critics, on the other hand, argue that programs providing tax incentives for locating in designated zones often result in significantly less job growth than claimed by supporters. Tax subsidy programs may result in new development, but they also provide tax breaks to development that would have occurred without those incentives. The overall cost per job created can be very large if little additional development was induced by the program.

Some critics of JOBZ have also pointed out that Minnesota's program is not targeted to the areas in Greater Minnesota with the most economic distress. JOBZ is available and has been used by cities with growing populations and generally prosperous economies.

As a result of these conflicting claims and arguments, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate the JOBZ program. Legislators were interested in the economic impact of JOBZ and the extent to which the program has been targeted to more economically distressed communities and areas in Greater Minnesota. In addition, legislators were interested in whether there has been adequate follow-up to ensure that participating businesses not meeting their job and wage requirements are removed from the program. This report specifically addresses the following issues:

[1] Greater Minnesota includes all of the state except the Twin Cities metropolitan area. The metropolitan area includes the counties of Anoka; Carver; Dakota, excluding the city of Northfield; Hennepin, excluding the cities of Hanover and Rockford; Ramsey; Scott, excluding the city of New Prague; and Washington. See *Minnesota Statutes* 2007, 469.312, subd. 3, and 473.121, subd. 2.

- **To what extent is the JOBZ program benefiting more economically distressed areas?**

- **What is the economic impact of the JOBZ program in Greater Minnesota? How could the program be changed to increase its net economic benefits to Greater Minnesota?**

- **How well has the JOBZ program been implemented? Is there effective oversight and accountability?**

To conduct this evaluation, we reviewed economic studies of enterprise zones and economic development and examined available analyses of Minnesota's JOBZ program. We also interviewed staff at the Department of Employment and Economic Development (DEED) and the Department of Revenue (DOR), as well as local government officials responsible for economic development. We examined in detail many of the documents collected by DEED on participating JOBZ businesses and, to the extent possible, reviewed their wage and employment records as filed with DEED for unemployment insurance purposes. Finally, we reviewed tax data filed with DOR.

Chapter 1 of this report provides background information on the JOBZ program. Chapter 2 examines the extent to which the program is targeted to economically distressed communities. In Chapter 3, we review the administration and operation of the program. In particular, we focus on the written agreements between participating businesses and local governments. We also examine the process used to review compliance of participating businesses with the job and wage requirements in these agreements and to remove noncompliant businesses from the program. Finally, in Chapter 4, we consider the economic impact of JOBZ in light of existing studies of tax incentives and the evidence we gathered on JOBZ. We also consider ways to improve the net economic impact of the program.

1 Background

SUMMARY

In 2004, the Job Opportunity Building Zone (JOBZ) program began providing significant state and local tax breaks to selected businesses in an effort to stimulate the economy of Greater Minnesota and revitalize economically distressed rural areas. Local governments largely decide which businesses may participate in the program and how much employment growth or capital investment is expected of participating businesses. The state has played a very limited role in determining business participation and establishing employment requirements for JOBZ businesses even though state government pays for much of the program's cost.

For nearly two decades, Minnesota has had enterprise zone programs in five cities on the state's western border. The border city enterprise zone program has provided certain tax breaks to companies locating in these zones. The purpose of these tax breaks was to dissuade businesses from relocating to the neighboring states of North Dakota and South Dakota and encourage development in Minnesota's border communities. Lower taxes and other business costs had caused businesses with both Minnesota and non-Minnesota customers to move across the border to the Dakotas. Tax breaks were used in an attempt to level the playing field in the competition for business development.

More recently, advocates for other Greater Minnesota communities argued that the need for significant tax breaks to retain and attract business activity was more widespread. Some counties in Greater Minnesota had experienced substantial job losses or declining populations. Without tax breaks or other assistance, it was believed that these areas were unlikely to recover from those losses.

In 2001, some legislators introduced bills to address their concerns about the economic future of certain areas in Greater Minnesota. These bills, modeled in part after programs in Michigan and Pennsylvania, would have established up to ten tax-free zones in Greater Minnesota. Each zone could have been no larger than 5,000 acres and could have contained no more than six noncontiguous subzones. Each subzone would have been required to cover at least 20 acres of property. The zones would have been chosen based on their economic distress and the likelihood of program success.

Under these 2001 bills, residents of the tax-free zones would have been exempt from property and income taxes. Businesses already in the zones and certain businesses that subsequently relocated to the zones would have been eligible for reductions in property, income, and sales taxes.[1]

Although these bills did not pass in either 2001 or 2002, legislators introduced very similar legislation again in 2003. The 2003 Legislature enacted a significantly modified version of the original proposal and named it the Job Opportunity Building Zones (JOBZ) program.[2] Under the JOBZ program, businesses located in designated zones would be eligible for tax breaks, but not residents of those zones. Amendments to the original proposal also made it possible for the zones to be spread more widely across Greater Minnesota and to consist of smaller individual portions of land than originally envisioned.[3]

This chapter provides more information on the program adopted in 2003 and implemented starting in 2004. In particular, we address the following questions:

- **How can a business qualify for the JOBZ program?**
- **What tax reductions does the program provide?**
- **What requirements must a participating business meet in order to continue receiving tax reductions? How do government agencies monitor compliance with these requirements?**
- **What government agencies are responsible for administering the program and deciding which businesses can participate?**
- **How has participation in the program grown since its inception in 2004?**

To answer these questions, we reviewed the original legislation and later changes made by the Legislature, program literature published by the Department of Employment and Economic Development (DEED) and the Department of Revenue (DOR), and documents in DEED's files related to individual JOBZ businesses. We also interviewed program staff at both agencies and local government officials that have been involved with the program.

QUALIFYING FOR JOBZ

To qualify for JOBZ tax breaks, a business must locate in a designated zone and sign a business subsidy agreement with a local government that is participating in

[1] If a business relocated operations to a zone, it would have qualified for the tax breaks if it either: (1) increased employment by 20 percent in its first full year of zone operations, or (2) made a capital investment in the zone equal to at least 10 percent of its gross revenues from the year prior to relocating to the zone. For purposes of calculating gross revenues, only the revenues from the portion of the business being relocated were to be counted.

[2] *Laws of Minnesota* First Special Session 2003, chapter 21, art. 1. Most of the law is codified in *Minnesota Statutes* 2007, 469.310 – 469.3201.

[3] The JOBZ legislation allowed an unlimited number of noncontiguous subzones in each of the ten zones and did not set a minimum size for each subzone.

the program. This section discusses those requirements, as well as any state requirements on the types of businesses that can participate in the program and the amount of employment growth or capital investment they must make to qualify for tax breaks.

Zone Designation

Before businesses could participate in JOBZ, the Department of Employment and Economic Development had to first designate the zones and subzones where businesses could qualify for tax exemptions. The 2003 legislation establishing a JOBZ program required DEED to publish application forms and requirements no later than August 1, 2003. Applications were due by October 15, 2003, and the commissioner of DEED was required to designate the zones by December 31, 2003, with the eligibility for tax breaks beginning January 1, 2004.

The 2003 law allowed the commissioner to designate up to ten zones.[4] Each zone could consist of an unlimited number of noncontiguous subzones but could not exceed a total of 5,000 acres. Although the commissioner was allowed to reserve one or more of the ten zones for a second round of designations effective on January 1, 2005, the commissioner designated all ten zones during the initial round of selections. However, the commissioner did not designate a full 5,000 acres in each of the ten zones. Only about 29,000 acres were designated in the ten zones. Because the commissioner has the authority to modify the original zone designations, the commissioner could increase the number of acres in each zone up to the 5,000 acre limit. While the commissioner has made numerous modifications to the original zones, only modest increases in total zone acreage have occurred.[5]

Local governments control participation in the JOBZ program.

Local Business Subsidy Agreements

Starting in 2004, businesses locating in a designated zone were eligible for the tax breaks provided in the legislation. To receive the tax breaks, businesses had to enter into a business subsidy agreement with a local government, such as a city, county, or township.[6] A business subsidy agreement lays out the contractual

[4] Besides the ten JOBZ zones, the commissioner of DEED was given the authority to designate up to five agricultural processing facility zones. An agricultural processing facility is an operation that transforms, packages, sorts, or grades livestock or livestock products, agricultural commodities, or plants or plant products into goods used for intermediate or final consumption. The size of each agricultural processing facility zone is limited to the property necessary for the facility and ancilliary operations, as well as space for expansion in the reasonably foreseeable future. To date, the commissioner has designated one agricultural processing facility zone, which includes two soybean processing plants.

[5] Chapter 2 will discuss the zone designation and zone modification processes in greater detail.

[6] The 2003 legislation indirectly required business subsidy agreements by requiring local governments to comply with the state's business subsidy law in administering JOBZ. (See *Minnesota Statutes* 2007, 469.313, subd. 2(5); and 116J.994, subd. 3.) The 2005 Legislature clarified that a business only qualified for JOBZ tax breaks if it had entered a business subsidy agreement. That provision, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11b, was made retroactive to the beginning of the program.

obligations of both the business and the local government. From a public perspective, one of the main purposes of a business subsidy agreement is to establish the job, wage, and capital investment requirements that a business must meet in order to receive JOBZ tax breaks.

The content of business subsidy agreements for JOBZ is determined by negotiations between local governments and interested businesses. DEED provides local governments with a sample business subsidy agreement. However, local governments have the discretion to use the sample agreement, modify it, or use their own agreement. DEED does not review the details of local business subsidy agreements.

State Requirements

There are few state requirements for program participation.

There are relatively few state restrictions governing the types of businesses that can participate in JOBZ and the amount of employment required to qualify for tax breaks. The wage levels required of JOBZ businesses are also relatively low, although higher wages are needed in order to benefit from a jobs tax credit.

Types of Businesses

Overall, the JOBZ program has been primarily used by manufacturers. But there has also been participation by businesses in other industries such as services, construction, wholesale trade, retail, and utilities.

State law did not initially place any restrictions on the type of commercial or industrial business that could participate in the JOBZ program.[7] However, in response to participation by some retail businesses and one public utility, the 2005 Legislature prohibited future participation by public utilities and limited the participation of businesses with retail operations in a JOBZ zone.[8] The restriction on retail participation allows some retail sales by a participating business at its JOBZ location. However, at its location in the zone, the business cannot be primarily engaged in making retail sales to purchasers who are

[7] Although there were no specific restrictions on the types of businesses that could participate in the program, property in a zone had to be classified as commercial, industrial, or public utility property in order to qualify for property tax exemptions. This meant that some resorts, hospitals, aircraft hangars, and golf courses were not eligible for the property tax exemption. See *Minnesota Statutes* 2007, 272.02, subd. 64; and 273.13, subd. 24.

[8] For the prohibition on utility participation, see *Laws of Minnesota* First Special Session 2005, chapter 3, art. 7, sec. 12, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11h. The prohibition on public utility participation applied to any business subsidy agreements entered into after July 14, 2005. For the restriction on retail participation, see *Laws of Minnesota* First Special Session 2005, chapter 1, art. 4, sec. 107, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11f. The restrictions on retail participation became effective for business subsidy agreements finalized after June 30, 2005.

physically present at that location.[9] Phone or internet sales or non-retail activities, such as service and repairs, do not count as retail sales for the purposes of this restriction.

DEED does not have policies that limit the participation of various types of businesses other than the requirements of state law. However, DEED has discouraged the participation of retail businesses in several ways. In selecting the initial zones, DEED often removed property designated for retail development from the zones. DEED has also occasionally used its power to approve zone modifications to discourage or prevent the use of JOBZ for some retail businesses. Nevertheless, some purely retail businesses and some businesses which have a mixture of retail and other operations have participated in the program.

Employment and Capital Investment

For most JOBZ businesses, there are no state requirements for minimum increases in employment or capital investment. The employment or investment requirements are determined through negotiations between local governments and businesses and are spelled out in business subsidy agreements.

However, businesses relocating any existing Minnesota operations into a zone must meet certain statutory requirements and sign a relocation agreement with DEED. The initial statutory requirements enacted in 2003 required a relocating business to increase full-time employment in the first full year of operation by at least 20 percent relative to the operations that were relocated or make a capital investment in the zone of at least 10 percent of the gross revenues of the relocated operations in the preceding tax year.[10]

The statutory requirements for businesses relocating within Minnesota were strengthened in 2005.

A number of participating businesses met these requirements using the capital investment option and committed to little or no job growth. Alternatively, some small businesses were able to meet the job growth option by promising to increase overall employment by only one or two jobs. As a result, the 2005 Legislature eliminated the capital investment alternative and strengthened the employment growth requirements for relocating businesses signing JOBZ agreements after June 30, 2005. Since then, relocating businesses have been required to increase full-time employment by a minimum of five jobs or 20 percent of the relocated operations, whichever is greater.[11]

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[9] The Department of Revenue has published Revenue Notice 06-02, which addresses a number of issues regarding the definition of "retail." However, neither Revenue's publication nor *Minnesota Statutes* 2007, 469.310, subd. 11f, defines how to measure whether these types of retail operations are the "primary" function of a business. Presumably, the proportion of total sales at the JOBZ location, or the proportion of employees assigned to such retail operations, could be used to measure whether a business qualifies for JOBZ.

[10] *Laws of Minnesota* First Special Session 2003, chapter 21, art. 1, sec. 15.

[11] *Minnesota Statutes* 2007, 469.310, subd. 11d. The same legislation also gave the commissioner of DEED the authority to waive the statutory employment requirements for relocating businesses. See *Minnesota Statutes* 2007, 469.310, subd. 11e.

Compensation Levels

Starting in July 2005, new participants were required to pay a minimum compensation level to all employees in a zone location.

Initially, there were no statewide requirements regarding the wages and benefits paid to workers of JOBZ businesses. State law required local governments to include wage requirements in the business subsidy agreements but did not set minimum wage and benefit levels.[12]

However, the 2005 Legislature enacted a minimum compensation requirement applicable to all JOBZ businesses completing a business subsidy agreement after June 30, 2005. Those businesses are required to pay each employee at its zone location compensation that is equal on an annualized basis to at least 110 percent of the federal poverty level for a family of four.[13] In addition to wages, state law allows compensation to include benefits that are not mandated by law.[14] Each year, DEED notifies JOBZ administrators regarding any changes in the minimum compensation rate. Beginning on July 1, 2005, the minimum hourly compensation rate was $10.23 per hour. That rate was updated to $10.58 per hour on July 1, 2006, and $10.92 per hour on July 1, 2007.

In addition, one of the tax breaks available to JOBZ businesses—the jobs tax credit—can only be obtained if the business pays an average wage well in excess of the statutory requirement.

Prevailing Wage Rates on Construction

Contractors and subcontractors must pay the "prevailing wage rate" on construction work in a zone.

In addition to any requirements on the wages paid by JOBZ businesses to their employees, contractors and subcontractors must pay the prevailing wage rate for any construction work in a JOBZ location.[15] Under current law, if a business receives certain state financial assistance for economic development, including sales tax reductions, then any construction, installation, remodeling, or repairs for which the assistance was provided is subject to the state's prevailing wage requirements for public construction projects.[16] An October 2004 opinion from the Attorney General's Office concluded that a JOBZ business could not decline the sales tax reduction on construction materials and thus avoid the prevailing wage requirement on zone construction work.[17]

The prevailing wage requirement has been a concern for prospective JOBZ businesses in some parts of the state. They have complained that the requirement forces them to pay substantially more for construction work than they otherwise

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[12] *Minnesota Statutes* 2003, 116J.994, subd. 4.

[13] See *Laws of Minnesota* First Special Session 2005, chapter 1, sec. 107, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11g.

[14] For example, health care benefits could be counted as compensation. Social security and Medicare contributions, unemployment insurance taxes, and workers compensation payments are required by law and cannot be included to meet the minimum compensation levels required by law.

[15] *Minnesota Statutes* 2007, 116J.871.

[16] *Minnesota Statutes* 2007, 177.42, subd. 6.

[17] Kristine L. Eiden, Chief Deputy Attorney General, Office of the Attorney General, letter to Senator Ellen Anderson and Senator Thomas Bakk, October 12, 2004.

would pay using local construction firms. In fact, the businesses claim that the prevailing wage requirement costs them more than the value of the sales tax exemption on construction materials. However, the Attorney General's opinion prevents them from selectively declining one of the tax breaks available under the JOBZ program in order to be exempt from the prevailing wage requirement. As a result, a few businesses have decided not to participate in the program.

To some extent, the concerns raised by these businesses were confirmed in a 2007 evaluation report by the Office of the Legislative Auditor on prevailing wage rates.[18] We found that problems with the methods used to calculate prevailing wage rates can cause the rates to be unrepresentative of compensation rates paid in some parts of the state. The problems involve both the calculation methods required by state law and inadequate response rates to surveys used to set prevailing wage rates. Our report made recommendations designed to improve survey response rates and suggested ways in which the statutorily mandated calculation method could be modified.[19]

Other Requirements

Starting in July 2005, local governments were required to consider a number of factors prior to entering into a business subsidy agreement.

Initially, state law did not require local governments entering business subsidy agreements to conduct any particular analyses of their JOBZ deals. Due to concerns about some of the deals entered into by local governments, the 2005 Legislature required local governments to consider a number of factors prior to entering any JOBZ business subsidy agreement after June 30, 2005.[20] The factors include: (1) the wages to be paid by a prospective JOBZ business in comparison to the regional industry average; (2) the number of jobs to be provided by the business relative to overall community employment; (3) the economic outlook for the industry in which the JOBZ business would compete; (4) sales that the JOBZ business would generate from outside the state of Minnesota; (5) the degree to which the business would build on existing regional strengths or diversify the regional economy; (6) the amount of capital investment to be made by the JOBZ business in the zone; and (7) any other criteria the commissioner of DEED deemed necessary.

In response to this statutory requirement, DEED developed a deal evaluator tool that rates each prospective JOBZ deal. The six factors mentioned in state law are included in the deal evaluator. In addition, the evaluator includes: (1) the increase in property tax base that will occur once the JOBZ property tax

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[18] Office of the Legislative Auditor, *Prevailing Wages* (St. Paul, 2007).

[19] Prior to the issuance of our prevailing wage report, a JOBZ business owner in Otter Tail County worked with the Minnesota Department of Labor and Industry to improve survey response rates in that county. Because it takes time for a new survey to be conducted and prevailing wage rates to reflect the new survey, these efforts did not reduce construction costs for this owner. However, they have lowered prevailing wage rates and construction costs for subsequent JOBZ businesses in the county. According to city economic development officials, the new rates still result in higher construction costs than without the prevailing wage requirement, but the value of the sales tax exemptions now exceeds these additional costs.

[20] See *Laws of Minnesota* First Special Session 2005, chapter 1, sec. 107, which is codified in *Minnesota Statutes* 2007, 469.310, subd. 11c.

exemptions have expired, and (2) the extent to which wages paid by the business exceed the statutory requirement of 110 percent of the federal poverty level for a family of four. DEED has required all local governments to submit a completed deal evaluator when a local government enters a business subsidy agreement.

TAX REDUCTIONS

The JOBZ program provides qualified businesses with substantial state and local tax reductions. This section examines the types of tax reductions offered to JOBZ businesses, the duration of the tax breaks, and the overall size and source of the tax reductions.

Types

JOBZ businesses and certain other businesses are eligible for various tax exemptions.

JOBZ businesses may receive tax reductions for sales and use taxes, property taxes, corporate franchise taxes, individual income taxes, and wind energy production taxes. In addition, other businesses renting or leasing property or equipment to JOBZ businesses may receive certain tax reductions. Finally, contractors and subcontractors constructing buildings or other improvements for a JOBZ business or for the business's landlord may receive sales tax reductions. In providing tax breaks to nonparticipating businesses, policymakers are assuming that JOBZ businesses will benefit by negotiating lower rental rates or construction prices. Each tax break allowed under the JOBZ program is discussed below.

Sales and Use Tax on Construction Materials and Supplies

Sales and use taxes on construction materials and supplies used in, and equipment incorporated in, the construction of buildings and other improvements to real property in a zone are exempt if, after completion, the improvements are used by a JOBZ business. This exemption can be used either by a JOBZ business, a person or business renting the building to a JOBZ business, or contractors or subcontractors either working for the JOBZ business or its landlord.

To buy these items without paying state or local sales or use taxes, the purchaser must give each seller a completed Certificate of Exemption form indicating that the reason for the exemption is JOBZ. The purchaser is not required to indicate the JOBZ business for which the construction materials and supplies are being used. In addition, the certificate does not indicate either the amount of exempt purchases or the tax savings. As a result, the amount of sales tax exemptions received on behalf of a JOBZ business can be difficult to determine.

Sales and Use Tax on Goods and Taxable Services

In addition, purchases of tangible personal property and taxable services by a JOBZ business are exempt from state and local sales and use taxes. To qualify for the exemption, these purchases must be "primarily" used or consumed at the zone location.[21] Items that can be purchased exempt from taxation include production equipment, nonproduction equipment, office supplies, and utilities. State law already exempts from sales and use taxes capital equipment for production uses such as manufacturing, fabricating, mining, or refining. But companies must first pay the tax and file a request for a refund. JOBZ businesses need not pay the tax at the point of sale and thus avoid the need to file a refund request.

To buy these goods and services without paying the sales and use taxes, the purchaser must file a Certificate of Exemption, as is the case for construction purchases. However, only a JOBZ business is eligible to purchase these goods and services without paying taxes.

Sales and Use Tax on Motor Vehicles

JOBZ businesses may also purchase motor vehicles without paying applicable state and local sales and use taxes. The purchase is tax exempt if the motor vehicle is principally garaged in the zone and is primarily used as part of, or in direct support of, the person's operations carried on in the zone.[22] To claim the exemption, the purchaser must submit a statement at the time of registration indicating that the purchaser is a qualified JOBZ business and has a business subsidy agreement with a local government.

Property Tax on Zone Buildings and Improvements

Property tax exemptions are allowed for buildings but not land.

JOBZ businesses are exempt from some property taxes. The exemption applies only to improvements to real property and personal property classified as commercial/industrial and located in a zone.[23] The exemption does not apply to the land portion of the zone property. The exemption is also not applicable to any levies used to pay general obligation bonds.[24] For taxes payable from 2005 through 2007, the exemption did not apply to school district referendum levies approved by voters before the designation of the zones on January 1, 2004.[25] However, for taxes payable beginning in 2008, JOBZ businesses will be exempt from paying referendum levies and will instead be required to pay any school district debt service levies included in the debt service levy under *Minnesota Statutes* 2007, 123B.55.[26]

[21] According to the Department of Revenue, "primarily" means fifty percent or more.

[22] *Minnesota Statutes* 2007, 297B.03.

[23] *Minnesota Statutes* 2007, 272.02, subd. 64a. The term "improvements" applies to any buildings or other property improvements in the zone. It is not intended to distinguish new buildings from existing buildings. The term "improvements" distinguishes buildings or other improvements from the land portion of the property's market value.

[24] *Minnesota Statutes* 2007, 272.02, subd. 64d(1).

[25] *Minnesota Statutes* 2006, 272.02, subd. 64d(2).

[26] *Minnesota Statutes* 2007, 272.02, subd. 64d(2).

In Minnesota, properties are assessed in one year, and the property taxes based on that assessment of market value are paid during the following year. As a result, the first year that any JOBZ business could have benefited from property tax exemptions was 2005.[27] This is because the first year any JOBZ business could have property in a zone was 2004. In addition, some early JOBZ participants did not complete their construction projects in 2004 and would have first received an exemption during assessment year 2005 or 2006. Consequently, their tax breaks would have started in either 2006 or 2007.

Property tax exemptions only cover the portion of a building that is in a zone and is occupied by a JOBZ business.

Not all buildings on a parcel of land occupied by a JOBZ business are necessarily in a JOBZ zone. The buildings on a parcel of land, or even an individual building on that parcel, may be split between zone property and fully taxable property. In some cases where a business is expanding an existing operation, the zone has been drawn to exclude existing structures on the parcel of land. If the company is expanding by constructing additional buildings on the same parcel, the new buildings would likely be in the zone, while the existing buildings may be outside the zone. If the company is expanding an existing building, the footprint of the existing building may be excluded from the zone, while expansion to the existing structure is placed in a zone. The intent of such an action is to exclude existing business operations from receiving favorable tax treatment but to provide an incentive for expansions.[28]

In some cases, a JOBZ business may occupy only a part of the building on a parcel of land. The zone designation would then only apply to the portions of a building that are occupied by a qualified JOBZ business. This would happen if the JOBZ business is renting part of a building or if a JOBZ business owns one of the office condo units on a parcel of land. In these instances, county assessors are supposed to determine the portion of the building that is occupied by the JOBZ business and give a tax exemption to only that portion of the building.

Business Income

JOBZ businesses are allowed an exemption from the individual income tax and the corporate franchise tax, including alternative minimum tax, for income attributable to zone activities. Determining the exemption amount is a three-step process.[29]

First, the portion of the Minnesota income of a JOBZ business that is attributable to the zone—or "zone percentage"—must be determined. For a business, the

[27] State law currently requires that property in a zone can be given a JOBZ exemption during the assessment year only if the business subsidy agreement is signed by July 1 of the assessment year and the JOBZ business begins operations in the zone by July 1 of that year. If those conditions are met, the business would first receive an exemption from certain property taxes during the following year when taxes based on the assessment are due.

[28] DEED initiated this general practice when it first designated the zones. During the zone designation process, DEED often—though not always—excluded the footprint of any occupied existing buildings on a parcel of land from a zone if it included the parcel in a zone.

[29] The calculation of these tax reductions is codified in *Minnesota Statutes* 2007, 469.316, subd. 3, and 469.317.

zone percentage is an average of the percentage of its Minnesota property that is in the zone and the percentage of its Minnesota payroll that is in the zone.[30] A company's Minnesota business income is multiplied by the zone percentage to determine the business income attributable to zone activities.

Calculating the amount of exempt business income can be complicated.

Second, if a JOBZ business relocated Minnesota operations into a zone and entered into a business subsidy agreement after August 31, 2005, the results from the first step must be multiplied by a "relocation payroll percentage" to determine the final exemption amount. Applying this percentage reduces the exemption amount by a fraction equal to the company's payroll from the relocated operations in the last full year prior to the relocation divided by the company's zone payroll for the current tax year. This second step means that businesses that relocated within Minnesota receive an exemption only to the extent that they have increased the payroll of their relocated operations.

Finally, state law places a limit on the exemption amount that is equal to 20 percent times the sum of the company's zone payroll and the adjusted basis of property at the time the property is first used in the zone. This limit replaces the exemption amount determined in the second step if it is less.

The final exemption amount is then deducted from a company's business income before taxes are computed based on that income. If a JOBZ exemption reduces a taxpayer's Minnesota taxable income below zero, the loss cannot be carried over to prior or future years.

Rental Income

Rental income received by individuals and businesses is exempt from income taxes if the income is from the rental or lease of real or personal property used by a qualified JOBZ business and located in a zone.[31] If the personal property was used both within and outside the zone, the rental income exemption must be prorated based on the portion of the year it was used in the zone.

Capital Gains Income

There are two types of capital gains exemptions. First, individuals may receive a state income tax exemption for capital gains on the sale of an ownership interest in a JOBZ business that is a partnership or corporation. The exemption amount is determined by multiplying a modified zone percentage times the amount of the gain. The modified zone percentage is similar to the zone percentage used in

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[30] Zone payroll includes payroll that is paid for services performed in the zone or for services performed outside the zone by an employee with an office in the zone, provided that the employee's work outside the zone is incidental to the work the employee performs inside the zone.

[31] C corporations are not eligible for this exemption. C corporations are those corporations that pay federal corporate income taxes and, in Minnesota, the corporate franchise tax. In contrast, S corporations distribute their earnings to their shareholders who must pay individual income taxes on that income. It is typical for real estate to be owned by S corporations, partnerships, or individuals since it receives more favorable tax treatment in those arrangements. However, there are restrictions on such arrangements. For example, an S corporation must have no more than 100 shareholders.

calculating a business income exemption except that non-Minnesota payroll and property must also be included in the calculation. The modified zone percentage must be at least 25 percent in order for an owner to qualify for an exemption.

Second, capital gains on the sale of real property or tangible personal property are exempt from income taxes if the property was used inside a zone by a JOBZ business. This exemption may be claimed by individuals and businesses that are JOBZ businesses or that rent this property to a JOBZ business.[32] If real property was owned prior to the designation of the zone, the capital gains exemption is prorated based on the number of days it was held during the period of zone designation relative to the total number of days of ownership. The capital gains exemption for tangible personal property is prorated based on the number of days the asset was used by a qualified business in the zone relative to the total number of days the property was held.

Jobs Credit

JOBZ businesses are also eligible for refundable jobs credits.

The JOBZ jobs credit provides a refundable tax credit for JOBZ businesses or their owners on income and corporate franchise taxes.[33] The credit is generally not available unless a JOBZ business pays an average wage of more than $30,000 per year to employees working in the zone. The credit is equal to 7 percent of the difference between: (1) the growth in zone payroll from the base year to the current tax year and (2) $30,000 multiplied by growth in the number of full-time equivalent (FTE) employees in the zone from the base year to the taxable year. If the growth in the total Minnesota payroll of the JOBZ business from the base year to the current tax year is less than the growth in zone payroll for those years (item 1 above), then the growth in total Minnesota payroll is used instead of the growth in zone payroll.

In calculating the credit, the zone payroll, which consists of the wages and salaries paid to employees, must be adjusted to exclude the compensation paid to any employee that exceeds $100,000. The $30,000 and $100,000 figures initially used in 2004 are adjusted for inflation each year and were $32,880 and $109,600 respectively for 2007.

The term "base year" is defined by law as the taxable year beginning during the calendar year prior to the year in which the zone designation took effect.[34] Since the zone designations became effective on January 1, 2004, the Department of Revenue has used 2003 as the base year.

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[32] As with the rental income exemption, C corporations are not eligible for a capital gains exemption.

[33] *Minnesota Statutes* 2007, 469.318.

[34] *Minnesota Statutes* 2007, 469.318, subd. 2b.

2

Zone Selection

SUMMARY

Although state law required the Department of Employment and Economic Development (DEED) to consider economic distress when designating zones, the JOBZ program has not been targeted to economically disadvantaged parts of Greater Minnesota. DEED was able to include more than 350 cities and townships in the program because state law permitted each of the ten zones allowed to include an unlimited number of noncontiguous subzones. In addition, DEED and local governments worked to consolidate all of the subzone requests into just ten applications. Some more economically disadvantaged regions of the state have not benefited as much from JOBZ as other parts of Greater Minnesota.

Some critics of JOBZ have argued that the program has not targeted its efforts to the parts of Greater Minnesota most in need of an economic development boost. They say that, in designating JOBZ zones, the Department of Employment and Economic Development was supposed to target rural areas with the greatest level of economic distress. Even some legislators who supported the program in 2003 have expressed concern that JOBZ has not benefited the areas most in need of employment growth. Some have suggested that relatively prosperous cities in Greater Minnesota, such as Rochester and St. Cloud, should not have been included in the JOBZ program.

This chapter examines the legislation passed in 2003 and the processes used by DEED to designate and modify zones. We also compare the location of jobs at JOBZ businesses with incidence of economic distress across Greater Minnesota. In particular, we address the following questions:

- **What requirements did state law place on the zone selection process? To what extent did state law require DEED to designate JOBZ zones based on need or economic distress?**
- **What process and criteria did DEED use in establishing JOBZ zones? How has DEED modified the zones since their original establishment?**
- **In selecting and modifying zones, has DEED followed the requirements of state law?**
- **Have the jobs created by the JOBZ program been more likely to be located in relatively prosperous communities or in communities with higher levels of economic distress?**

The issues raised in this chapter will suggest a possible new direction for JOBZ. However, we will reserve any discussion of recommendations until Chapter 4.

3

Administration

SUMMARY

We found significant problems with the administration of the JOBZ program. Business subsidy agreements used by local governments are often poorly worded and sometimes fail to require the creation or retention of promised jobs. The local agreements, as well as the relocation agreements used by the Department of Employment and Economic Development (DEED), do not adequately define key terms such as "full-time equivalent employees" or "benefits." Furthermore, some agreements have required the creation of very few new jobs.

DEED's process to monitor business compliance with job and wage requirements is slow and based on questionable information. The forms used to collect information on the employment and wages at JOBZ businesses are confusing, lack sufficient instructions, and do not gather all of the information needed. The reports received by DEED are self-reported, unverified, and often overstate actual employment.

As discussed in Chapter 1, administration of JOBZ is decentralized and responsibility is dispersed. DEED, the Department of Revenue (DOR), and local government officials around the state all have important obligations under the law. In this chapter, we assess how these different entities have carried out their responsibilities to manage the JOBZ program. Specifically, we ask:

- **Has the program been effectively administered?**
- **Are businesses in the program meeting their obligations?**
- **If businesses fail to meet their obligations, are they identified and removed from the program? Are the tax incentives they have received repaid to state and local jurisdictions as required?**

To answer these questions, we reviewed the JOBZ statute and the state's business subsidy law.[1] We examined program documents for over two hundred JOBZ deals and conducted interviews with DEED staff, DOR staff, and local officials who have been involved with the JOBZ program. We reviewed the tax filings of numerous businesses and individuals claiming JOBZ tax benefits on their 2004 or 2005 Minnesota tax returns. Finally, we collected data reported to DEED by JOBZ businesses and local jurisdictions and compared this information with data drawn from the state's Unemployment Insurance system.

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[1] Unless otherwise noted, in this chapter we use the terms "business subsidy law" and "business subsidy statute" to refer to *Minnesota Statutes* 2007, 116J.993 – 116J.995, and we use the terms "JOBZ law" and "JOBZ statute" to refer to *Minnesota Statutes* 2007, 469.310 – 469.3201.

4

Effectiveness

SUMMARY

Reports from the Department of Employment and Economic Development (DEED) overstate the impact of JOBZ on employment and business investment in Greater Minnesota. The employment data used by DEED are suspect, and DEED's estimates fail to consider what businesses would have done without JOBZ breaks. In fact, DEED's surveys indicate that two-thirds of participating businesses would have expanded to some extent in Greater Minnesota without JOBZ tax breaks. About one-fourth of this group say that the subsidies had no impact on how much they expanded in Greater Minnesota. Furthermore, providing JOBZ subsidies to some businesses may not have had much effect on overall employment because the participants compete with existing Greater Minnesota businesses for the same local or regional customers in the state.

Although providing a precise estimate of the impact of JOBZ would be difficult, it is clear that the program should focus more on those business projects most likely to generate economic growth for Greater Minnesota. Cities and townships make decisions about business participation with few state guidelines or requirements and no constraints on the amount of state tax expenditures that can be used for JOBZ. Cities and townships lack a regional or state perspective on the benefits of subsidizing particular businesses and bear only a small share of the costs. The JOBZ program has some value as an economic development tool but needs to be used more selectively or be limited to use in economically distressed areas.

The main purpose of JOBZ has been to increase employment in Greater Minnesota, particularly in economically distressed areas. As we saw in Chapter 2, the JOBZ program has not been targeted to economically distressed areas. But proponents claim that the program has been beneficial in creating jobs in Greater Minnesota. In this chapter, we examine the effectiveness of the JOBZ program in creating new jobs. We also consider whether the JOBZ program is designed and operated in a manner that maximizes its job creation potential and minimizes unneeded subsidies. In particular, we examine the following issues:

- **What have national economic studies concluded about the impact of enterprise zone and other tax incentives?**
- **How has the Department of Employment and Economic Development measured the impact of JOBZ on employment and wages? What are the shortcomings of DEED's approach?**
- **Can the impact or effectiveness of the JOBZ program be more accurately measured?**

List of Recommendations

- The Legislature should require that DEED review and approve all JOBZ business subsidy agreements before they can take effect. The separate relocation agreements could be discontinued if DEED makes sure that business subsidy agreements for relocating businesses include the statutory requirements (p. 59).

- DEED should ensure that business subsidy agreements contain meaningful but realistic requirements for businesses (p. 60)

- DEED should rewrite the sample business subsidy agreement to define key terms and correct grammatical errors. DEED should have revisions to the agreement reviewed by an attorney (p. 61).

- DEED should discontinue use of the deal evaluator (p. 61).

- DEED should streamline its compliance review process to produce more timely information about the progress of JOBZ businesses. DEED should move promptly to either remove noncompliant businesses from the program or provide an extension if warranted (p. 70).

- The Legislature should enact a stronger penalty for local governments that do not file required reports on time (p. 71).

- DEED should develop a compliance review process triggered by the deadlines listed in business subsidy agreements (p. 71).

- DEED should revamp the business subsidy reporting form (p. 71).

- The Legislature should require businesses to attest to the accuracy of their business subsidy reports (p. 72).

- DEED should use information from unemployment insurance filings to periodically check the performance of JOBZ businesses. DEED should require participating businesses to file their unemployment insurance data in a manner that would simplify compliance checking (p. 73).

- The Legislature should authorize the State Auditor to use state tax data and unemployment insurance data in ongoing audits of JOBZ compliance (p. 73).

February 4, 2008

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
140 Centennial Office Building
St. Paul, MN 55155-1603

Dear Mr. Nobles:

This letter is a response from the Department of Employment and Economic Development to your final report on Minnesota's Job Opportunity Building Zone (JOBZ) Program.

Thank you for the professionalism, thoughtfulness and courtesy of the team that worked on this important analysis. The report speaks to both policy and administrative aspects underlying this important economic development program's implementation. We appreciate the report's conclusions that JOBZ has value as an economic development tool and should be continued, and we agree with the findings that significant changes need to be made to increase state oversight and accountability for program performance. The report will serve as a useful basis for what those changes should be and we are committed to their implementation.

This response is organized to follow the four main recommendations contained in the report.

Recommendations:

(1) The Legislature should require DEED to review and approve all business subsidy agreements before they can become effective. DEED should also be required to implement meaningful criteria for determining whether a business should receive JOBZ assistance.

Response:

We agree that more meaningful state-level review is required. At its inception, JOBZ was formed as a state program with decisions largely driven by local judgment on selection of specific businesses for inclusion in the program. While we believed that was the legislative intent, four years of experience with the program give us sufficient reason to strongly agree that a new direction that meets statewide goals while respecting local decision making is needed.

DEED will work with cities and economic development leaders to design a new process and criteria to guide local decision-making. Because this represents a significant new direction, we believe legislation will be required to implement it. Under such a process, local governments proposing JOBZ projects would be required to submit preliminary applications - prior to holding a business subsidy hearing - explaining the proposed project. Included will be substantive elements that DEED could evaluate: whether the proposed project represents competition with other local or regional businesses, whether the JOBZ subsidy is required for the project to move forward, whether the investment and job creation or retention is sufficient to warrant the subsidy, and other factors that will support the state and local tax subsidy afforded by JOBZ. DEED would then act upon this application prior to local approval of business subsidy agreements. That process would match that of other DEED programs, principally the Minnesota Investment Fund, in which projects are evaluated and approved or rejected by the department before they can proceed.

(2) The Legislature should either limit the number of businesses allowed to enter the JOBZ program each year or limit the estimated cost of future subsidies for new entrants each year.

We do not think it feasible or reasonable, as the audit report recommends, to place a cap on the level of subsidies or number of new businesses entering the program. The new state oversight proposed above is likely to reduce the number of businesses entering the program, and we recommend the Legislature monitor the overall program cost over time to evaluate whether a cap needs to be imposed. Also, as the report observes, implementation of a cap on either the number of new entry businesses or the amount of subsidies in a given time period would be unwieldy or create the potential that the necessary projects would not be served. However, if the Legislature believes a cap of either kind is necessary DEED will work diligently to develop the means to implement it.

(3) DEED should revamp the reporting forms used to monitor compliance and measure the overall effectiveness of the program.

We agree with the report's recommendations that the Business Subsidy Agreement template provided to subzone administrators needs to be reviewed by the Attorney General and then used consistently for all future agreements. We also agree that a new Minnesota Business Assistance Form needs to be created to clarify terminology related to job creation and investment requirements.

(4) DEED should streamline its compliance process to more rapidly identify and remove from the program businesses that are clearly not meeting their obligations.

DEED agrees it is necessary to tighten the process of monitoring JOBZ business subsidy agreements. DEED will require that the new Minnesota Business Assistance Form be submitted in a more timely manner following the period for which the commitment was made. This will shorten by months the current process of receiving them on an annual basis along with the required reports for all other business subsidies. We expect this process alone, followed by closer communication and more systematic reporting with the Department of Revenue on compliance questions, will significantly tighten the monitoring of actual business performance relative to commitments. We will also establish a process by which the subzone administrator and the business certify that the job, wage, and investment commitments are accurate.

We also believe that management and staff assignment changes DEED has made in the past six months will have great benefit for improving the compliance process. DEED has never had substantial funding for the program, so limited internal capacity led decisions to attach its administration to other community economic development programs. In 2007 DEED reorganized its business and community development staff so that JOBZ is now part of the business financing group, whose work load and job and wage monitoring responsibilities are more closely aligned with heightened oversight of JOBZ. We believe this will address many of the audit report's findings and make a significant difference.

The report states that the program has not been sufficiently focused on economically distressed areas in greater Minnesota. With the Strategic Entrepreneurial Economic Development (SEED) initiatives that Governor Pawlenty will introduce in the 2008 session, DEED will propose that those greater Minnesota areas of greatest distress (measured by either long-term population loss or unemployment in excess of the statewide average) be permitted to enter into business subsidy agreements for a full twelve years of JOBZ, compared to ten years in greater Minnesota areas without those economic circumstances. Other programs in SEED will either be targeted exclusively or as a preference to those more distressed areas.

We look forward to working with the Legislature as we implement these suggested changes.

Sincerely,

Dan McElroy

Dan McElroy
Commissioner

MINNESOTA · REVENUE

February 4, 2008

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
140 Centennial Office Building
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

We thank the Office of Legislative Auditor for its thoughtful review and analysis of the Job Opportunity Building Zone (JOBZ) Program. We agree with the findings and recommendations specifically directed at the department.

We believe the JOBZ program is a valuable economic development tool. However, because it is a comprehensive and complex program it is appropriate that it be evaluated from time to time to ensure that it is being appropriately administered.

We agree with your recommendation that all JOBZ businesses should be required to submit the M500 tax form. This will enable us to get a complete set of information from all recipients on the tax benefits received during the tax year.

You have identified an error in the JOBZ tax form involving the order of application of the relocation percentage and the 20% benefit limitation. We agree with that finding and are in the process of correcting that form and the instructions.

You point out several modifications that should be addressed by the Legislature to clarify and amend statutes to improve the clawback provisions aimed at noncompliant businesses. We agree that some changes to these provisions are necessary. We have been working on proposed law changes since the last legislative session and we will be coming forward with a comprehensive proposal as part of our department tax bill. This will address both businesses that cease to operate in the zone and those that continue to operate in the zone but have not met their obligations under the business subsidy agreement.

You mention in the report a need for a greater coordination of effort and more timely communication between the Department of Employment and Economic Development (DEED), the counties and this department. This is especially true as it relates to businesses that are no longer operating as a qualified business in the zone. We agree with this recommendation as well. We will be seeking legislation requiring businesses to annually certify that they are still operating in the zone and are in compliance with the requirements of its business subsidy agreement. This will also be part of our department tax bill. We are committed to working with DEED and the counties to improve communications and make them more meaningful and timely.

Your recommendations and analysis will help us to improve the administration of the JOBZ program and hopefully provide the foundation that enables us to work successfully with the Legislature to get the necessary law changes enacted.

Again, we want to thank the OLA for their review and analysis of the Job Opportunity Building Zone Programs and we look forward to working with the Legislature, the Department of Employment and Economic Development and county tax officials in addressing the recommendations of the report.

Sincerely,

Ward Einess
Commissioner

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