

**Enterprise Zone Program**

**Department of Local Affairs  
Governor's Office of Economic Development  
and International Trade  
Colorado Economic Development Commission**



**Performance Audit  
November 2007**



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November 14, 2007

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Colorado Enterprise Zone Program. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the Colorado Office of the State Auditor to conduct audits of all departments, institutions, and agencies of state government and pursuant to Section 39-30-103(4)(c)(II), C.R.S., which requires the State Auditor to evaluate the implementation of the Enterprise Zone Program no less than once every five years. The Colorado Office of the State Auditor contracted with Clifton Gunderson LLP to conduct this performance audit in accordance with generally accepted government auditing standards.

Very truly yours,

*Clifton Gunderson LLP*

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# Colorado Enterprise Zone Program

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## Background

The General Assembly created Colorado's Enterprise Zone Program (Program) in 1986 "to provide incentives for private enterprise to expand and for new businesses to locate in economically depressed areas and to provide more job opportunities for residents of such areas." By statute, the number of zones is limited to 16. Any municipality, county, or group of contiguous municipalities may propose an area of the municipality, county, or group of municipalities or counties as an enterprise zone. As the shaded portions of the map in Appendix A illustrate, the existing 16 zones encompass about 70 percent of the State of Colorado's (State) land area. The geographical configurations of the 16 zones can be described as either county-inclusive or multi-site. Multi-site zones consist of selected land areas (census tracts, municipalities, streets, single sites, etc.) which are often scattered within each zone's outer boundaries.

According to statute, to be designated a zone, an area must have a population of less than 80,000, or less than 100,000 if a rural area, and meet one of the following criteria:

- An unemployment rate at least 25 percent above the state average.
- A population growth rate less than 25 percent of the state average.
- A per capita income less than 75 percent of the state average.

One-half (eight) of the existing zones were designated in 1986 - the year the Program began. The remaining eight zones were designated between 1987 and 1993. Of Colorado's 64 counties, all but nine are designated wholly (44) or partially (11) as enterprise zones. A few of the zones cover very large geographic areas. The Colorado Department of Local Affairs has authorized the East Central/Northeast and San Luis Valley/Upper Arkansas zones to delegate authority for zone administrative functions to two "sub-zone" administrators. The two sub-zone areas have separate economic objectives and plans, and report economic data to the Department of Local Affairs individually. The Program statutes are silent on the delegation of administrative functions to "sub-zone" administrators. The designation of "sub-zone" administrators does not change the requirement that the entire geographic area of the enterprise zone must meet the statutory criteria for zone designation, as opposed to each sub-zone qualifying separately.

## Enhanced Rural Enterprise Zones

In 2002, legislation established a new enhanced rural enterprise zone designation. According to the statute (Section 39-30-103.2(1), C.R.S.), “the portion of any county within an enterprise zone...shall be designated as an enhanced rural enterprise zone if the county that contains the area to be so designated meets two or more of the following criteria:”

- An unemployment rate of at least 50 percent above the state unemployment average.
- A population growth rate less than 25 percent of the state average.
- The average per capita income is less than 75 percent of the state average.
- The total assessed value of all non-residential property within the county ranks in the lower one-half of all counties.
- The county has a population of 5,000 or less.

Statute does not limit the number of areas that can be designated an enhanced rural enterprise zone. According to the statute (Section 39-30-103.2(2), C.R.S.), by December 1, 2002 and every two years thereafter, the Executive Director of the Department of Local Affairs is to determine whether each county meets two or more of the above listed criteria, based on the most recent statistics available to the State Demographer. The Executive Director is to then provide a list of counties that meet two or more of the criteria to each enterprise zone administrator and to the board of county commissioners of each eligible county.

In December 2006, the Executive Director of the Department of Local Affairs qualified 32 of Colorado’s 64 counties (50 percent) to contain enhanced rural enterprise zones. The 32 eligible counties are Alamosa, Archuleta, Baca, Bent, Chaffee, Cheyenne, Clear Creek, Conejos, Costilla, Crowley, Custer, Delta, Dolores, Hinsdale, Huerfano, Jackson, Kiowa, Kit Carson, Lake, Lincoln, Logan, Mineral, Moffat, Otero, Ouray, Phillips, Powers, Rio Grande, Saguache, San Juan, Sedgwick, and Washington. As will be discussed in more detail below (see New Business Facility Employee Credit), an additional \$2,500 in potential tax credits were made available to businesses located in enhanced rural enterprise zones.

## Enterprise Zone Tax Incentives

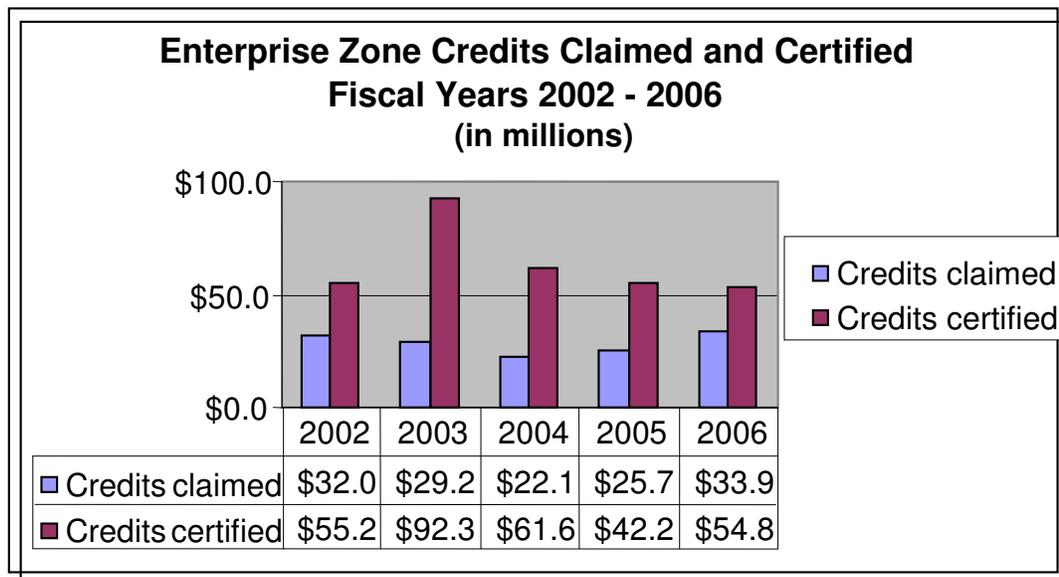
The Program’s incentives consist of 10 different tax credits (five are contained under the heading “New Business Facility Employee Credit”), one sales and use tax exemption, and the possibility for additional local government tax incentives. Program tax incentives are available to corporations, business partnerships, and individuals who locate, invest, or make contributions to qualifying activities within a zone. Enterprise Zone tax credits and exemptions include:

- **Investment Tax Credit.** A credit for 3 percent of qualifying equipment investments used exclusively in an enterprise zone. The investment tax credit continues to be the most widely used of the enterprise zone tax credits.
- **Job Training Credit.** A credit for 10 percent of the amount of investment for qualified job training programs for employees in the zones.
- **Research & Development Credit.** A credit for 3 percent of any increased research and development expenses in an enterprise zone.
- **Rehabilitation of Vacant Buildings Credit.** A credit for 25 percent of the qualified rehabilitation expenses to rehabilitate an older, unoccupied building in an enterprise zone, not to exceed \$50,000 per building.
- **Contributions to Zone Projects Credit.** A credit for 25 percent of the monetary, or 12.5 percent of in-kind, taxpayer contribution to an enterprise zone administrator, or to approved nonprofit or local government projects, for the purpose of implementing the enterprise zones' economic development plans, not to exceed \$100,000.
- **New Business Facility Employee Credits.** A \$500 credit for each new employee added by a new or qualifying expanded business facility in an enterprise zone. Additional credits are allowed for new employees covered by employer-sponsored health insurance (\$200 per new employee for the first two tax years following the date of qualification) and for businesses that manufacture products from agricultural commodities (an additional \$500 per new employee). Also, for tax years beginning on or after January 1, 2003, an additional \$2,000 credit for each new business facility employee is available to businesses located in an enhanced rural enterprise zone and an additional credit of \$500 for businesses that manufacture products from agricultural commodities in an enhanced rural enterprise zone. In total, a new business facility that manufactures products from agricultural commodities, offers health insurance, and is located in an enhanced rural enterprise zone could receive a credit of \$3,700 per new employee.
- **Manufacturing and Mining Equipment Sales Tax Exemption.** Purchases of machinery and machine tools in excess of \$500 in an enterprise zone are exempt from sales and use tax.

## Tax Credits Certified and Claimed

The amounts of tax credits certified and claimed are two important ways to measure the Enterprise Zone's impact on the State's economy and revenues. Additionally, the statute (Section 39-30-103(4)(b.7)(II), C.R.S.) requires that our report "include information concerning the amounts of tax credits claimed and allowed under the Program." The following is our analysis of the Enterprise Zone tax credits certified and claimed between Fiscal Years 2002 and 2006.

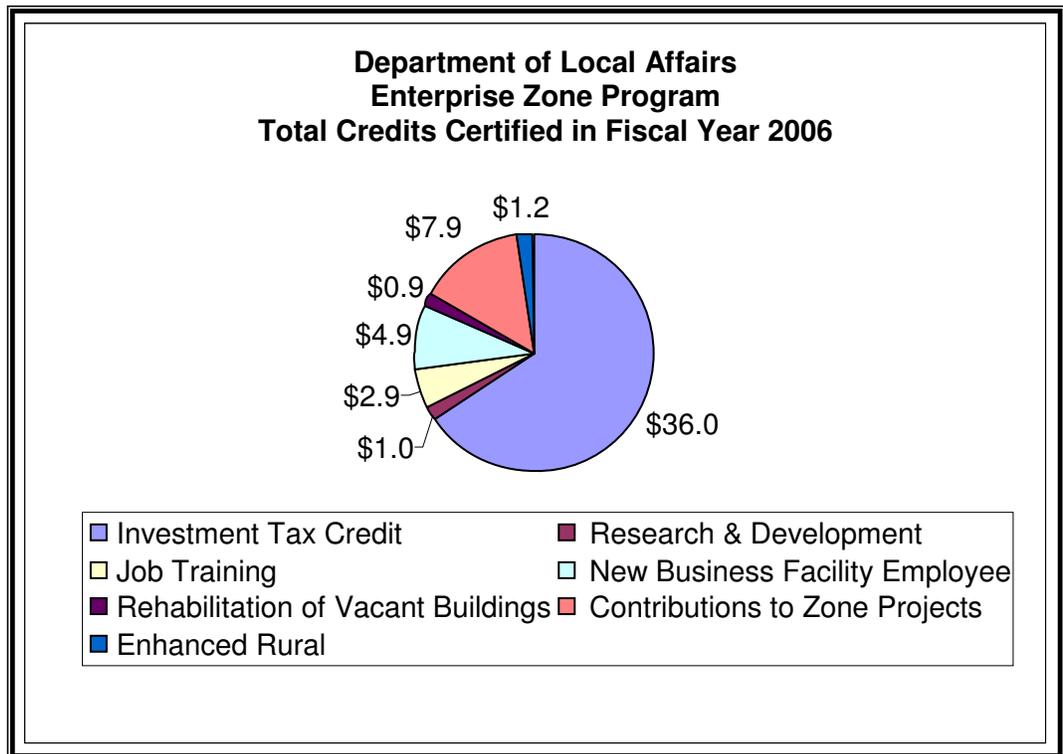
- Credits Certified.** To receive an Enterprise Zone tax credit, individuals, business partnerships, and corporations must complete one of the statutorily-required business or community activities (e.g., invest money in a qualified job training program for employees in an enterprise zone or contribute money to an approved local government project) and apply for and receive certification from the local zone administrator. The certification allows a business to use a credit to offset state income tax liabilities. The amount of credits certified represents the “potential cost” to the State in lost tax revenue if all certificates issued are actually claimed on tax returns. For Fiscal Year 2006, the potential tax credit value of certificates issued was \$54.8 million, down less than one percent from the \$55.2 million in tax credits certified in Fiscal Year 2002. Over the five-year period, the value of credits certified varied from year to year, with the highest value reported in Fiscal Year 2003 at slightly more than \$92 million in certified tax credits.
- Credits Claimed.** Not all credits certified are actually claimed on state income tax forms because participants do not always follow through and take the credits or there is insufficient tax liability in the current year for the taxpayer to take advantage of the credit. Therefore, in any given fiscal year, the value of the credits claimed typically will be less than the value of the credits certified. Credits not taken in the current year may be carried forward and used in subsequent years, and allowable carry forward periods vary by type of credit. Tax credits claimed can be described as the actual “current cost” to the State in lost tax revenue. The value of total credits claimed against income taxes for Fiscal Year 2006 was about \$33.9 million, compared to \$25.7 million claimed in Fiscal Year 2005 and \$22.1 million in Fiscal Year 2004.



Source: Department of Local Affairs, "Summary of Economic Indicators and Tax Credits Certified by Fiscal Year."

Although both credits certified and credits claimed have been used to evaluate the financial impact of the enterprise zone program, certification may be the better measurement because new businesses will typically not have profits and thus not have enough tax liability to initially claim the tax incentives. The certifications are more representative of the new business investment, job creation and training that have been injected into an enterprise zone than current credits claimed.

As the following exhibit shows, the investment tax credit is the most frequently certified credit. In Fiscal Year 2006, the value of the investment tax credits certified represented almost \$36 million of the total \$54.8 million in credits certified, or approximately 66 percent.



*Source: Auditor analysis of the Department of Local Affairs' Annual Enterprise Zone Report 2006.*

*Note: The New Business Facility Employee credit total includes Agriculture Processing and Health Insurance credits.*

## Statutory Changes

Since the last performance audit of the Enterprise Zone Program in 2002, several key statutory changes have occurred. First, House Bill 02-1161 expanded the Program by creating enhanced rural enterprise zones. As discussed earlier, the legislation increased the amount of the new business facility employee and agricultural new business facility employee credits for businesses located in enhanced rural enterprise zones. Second, House Bill 02-1399 repealed the requirement that the Economic Development Commission review the zones for possible termination within 12 months of the availability of 2000 Census data and then every five years thereafter. The five-year zone review requirement was originally added to the Program statutes in 1999 following recommendations made in the State Auditor's 1998 performance audit of the Program. Third,

Senate Bill 04-003 eliminated the requirement for the State Auditor to review the Department of Local Affairs' annual enterprise zone report every two years, and instead, required the Executive Director of the Department of Local Affairs to make an annual presentation to the Legislative Audit Committee reviewing and summarizing the information contained in the Department of Local Affairs' annual report. Last, three bills passed between 2005 and 2007 made modifications to several of the existing tax credits. We provide the complete legislative history of the Program in Appendix C.

## **Program Administration**

The Colorado Departments of Local Affairs and Revenue and the Governor's Office of Economic Development and International Trade and the Colorado Economic Development Commission all have a role in administering the Program. Specifically, the Colorado Department of Local Affairs prior to January 1, 1997 was responsible for the designation and termination of enterprise zones. Effective January 1, 1997, this responsibility was statutorily transferred to the Colorado Economic Development Commission (Commission). As noted above, the requirement for the Commission to review the zones for possible termination was repealed in 2002. According to the statute (Section 39-30-103(3), C.R.S.), the Department of Local Affairs is still required to collect annual documentation of each zones' efforts to improve conditions in enterprise zones, submit an annual report to the General Assembly summarizing the documentation submitted by zone administrators each year and make an annual presentation of this information to the Legislative Audit Committee, and every two years determine whether each county in the State qualifies as an enhanced rural enterprise zone. Although these statutory requirements are the responsibility of the Department of Local Affairs, the Department of Local Affairs shares these duties with the Colorado Governor's Office of Economic Development and International Trade. The Department of Local Affairs and the Commission share the costs of one full-time-equivalent position (FTE), administratively located in the Office of Economic Development and International Trade, to coordinate the Program.

The Colorado Department of Revenue is responsible for the collection of income taxes and for the enforcement of the State's tax laws. As part of these duties, the Department of Revenue promulgates rules and regulations, develops and publishes tax forms, and develops and publishes additional information regarding enterprise zone tax credits. The Department of Revenue is also responsible for auditing taxpayers to ensure the correct amount of taxes are paid, including verifying that only authorized tax credits are claimed.

Finally, each of Colorado's 16 enterprise zones is overseen by a local enterprise zone administrator. The zone administrator is designated by the local governments forming each enterprise zone. The zone administrators are responsible for implementing the zones' economic development plans, including achieving the zones' measurable economic development objectives. The zone administrator is also responsible for providing annual documentation to the Department of Local Affairs regarding the achievement of the zone's economic development objectives.

## Audit Scope

Section 39-30-103, (4)(c)(II), C.R.S., requires the State Auditor to conduct an audit no less than every five years of the Program. The Colorado Office of the State Auditor contracted with Clifton Gunderson LLP to conduct this performance audit, which was conducted in accordance with generally accepted government auditing standards. The purpose of this audit is to evaluate the overall implementation of the Program and its effect on the employment, unemployment rate, investment, overall growth rate, economic diversity, and per capita income in each enterprise zone and enhanced rural enterprise zone or county containing an enterprise zone or enhanced rural enterprise zone. The audit is also to evaluate the effectiveness of each enterprise zone in achieving its measurable objectives on the basis of data from the Department of Local Affairs and the zone administrators. The last audit was completed in November 2002.

The current audit of the Program covers the five-year period from 2002 to 2006 and consists of an evaluation of the overall implementation of the Program and its effect on the six economic indicators previously cited in both the enterprise zones and enhanced rural enterprise zones. Also, we reviewed the 2006 reports submitted by all zone administrators on the zones' individual goals and objectives and the documentation of efforts to improve the zones' respective economic conditions. Additionally, we conducted a more detailed review of six zones, consisting of on-site visits to the zone administrators' offices and testing of the accuracy of the data reported to the State for enterprise zone tax credit certificates. In addition, we reviewed the implementation status of the recommendations contained in the State Auditor's 2002 Performance Audit of the Enterprise Zone Program (see Appendix B).

## Program Implementation and Impacts

As previously discussed, the statute (Section 39-30-103 (4)(c)(II), C.R.S.) requires the State Auditor at least every five years to evaluate the implementation of the Program and its effect on the employment, unemployment rate, investment, overall growth rate, economic diversity, and per capita income in each enterprise zone and enhanced rural enterprise zone or county containing an enterprise zone or enhanced rural enterprise zone. Statutes also require the State Auditor to evaluate the effectiveness of each zone in achieving its measurable objectives. To fulfill these statutory requirements, this chapter contains the following:

- An evaluation of the implementation of the Program.
- An evaluation of the Program’s impact on economic conditions within the zones by discussing the impact of the State and national economies on the Program and by providing trend data on each of the six economic indicators referenced in statute.
- An evaluation of the effectiveness of each zone in achieving its enterprise zone objectives.

Overall, we found that the Departments of Local Affairs and Revenue and the Governor’s Office of Economic Development and International Trade and the Colorado Economic Development Commission have implemented the Enterprise Zone Program in accordance with existing statutory requirements. Although zone marketing efforts and documentation could be improved, and manual data entry resulted in some minor data collection and reporting errors, our fieldwork at six zone offices identified no significant operational issues. Our report contains no new findings or recommendations. Appendix B reports the implementation status of recommendations made in the Office of the State Auditor’s 2002 audit.

## Measuring Program Effectiveness

As reported in previous audits of the Program, the task of determining the Program’s impact on economic conditions is challenging. It is difficult to develop, or identify, a proven methodology to be used to isolate the causes of economic change. In addition, we have encountered the following obstacles:

- Incongruity between the goals of the Program (i.e., “to provide incentives for private enterprise to expand and for new businesses to locate in economically depressed areas and to provide more job opportunities for residents of such areas.” [Section 39-30-102, C.R.S.]) and its structure. For example, the goals are set by the State, but the Program is administered by local governments or non-profit agencies, and objectives developed by the zones are not necessarily directly linked to the goals set in statute.

- Zone boundaries and sub-zone areas that do not necessarily correspond to existing data sources such as census tracts, county lines, or city boundaries.
- Frequent program changes that make it difficult to compare conditions and impacts from one year to the next.
- Difficulty obtaining data that is complete and reliable. In addition, data may be collected by fiscal or calendar year.
- Other local and state incentives that impact business decisions to locate in a zone.

As such, similar to previous audits we have been unable to measure the relationship between enterprise zone status and changes in the economic conditions of designated zone areas. The following sections of the report provide trend data on each of the six economic indicators referenced in statute and explain the correlations that do or do not exist between changes in economic conditions and the implementation of the Program.

## Colorado's Economy

Generally, economic changes in the enterprise zones and enhanced rural enterprise zones closely mirror changes in Colorado's and the nation's economies. Below we provide a brief overview of the economic conditions that existed during the time period reviewed (2002 – 2006). Since our last five-year audit of the Program in 2002, economic conditions within the enterprise zones, enhanced rural zones, the non-zone areas of the State, and the State as a whole initially weakened and then improved. The slow-down in the State's economy began in late 2000 and was primarily driven by a slowing national economy. In March of 2001, the nation entered a recession, ending a record 10-year expansion. The State's continued down-turn in 2002 was worse than the nation as a whole and was affected by the same factors that impacted the national economy, including weaknesses in the manufacturing sector, low consumer confidence, extremely weak equity markets, and businesses that were not sufficiently confident to resume large-scale hiring. The significant weakness in Colorado's manufacturing, communications, and business services sectors contributed to a shrinking job market that negatively impacted income and spending. Additionally, compounded by the effects of the 2001 terrorist attacks, the national recession depressed Colorado's tourism industry.

Both the nation's and Colorado's economies began to improve in 2004, though Colorado lagged slightly behind the national economic recovery. The recovery continued in 2005 and 2006 with improvements in employment, personal income, consumer spending, and assessed property values. The Colorado economy continued to expand at a healthy, but moderate pace through 2006.

The available data supports a strong correlation between changes in the nation's and Colorado's economies. In addition, as will be discussed in more detail below, the available economic data shows that the economic indicators in zone and enhanced rural zone areas correlated, in most instances, to changes in the same indicators for the State as a whole. For example, economic data for 2006 show that the unemployment rate in the zones and enhanced rural zones improved consistent with the improvement in the state and national rates. Additionally, between 2002 and 2005 (most recent data available), the average per capita incomes for zones, enhanced rural zones, non-zone areas, the State, and nation increased by at least 10 percent. The overall growth rate was the one economic indicator in which the enhanced rural enterprise zones failed to track with changes in the other areas of the State. Specifically, between 2002 and 2005 the enhanced rural enterprise zones experienced declines in the number of business establishments and employment while the rest of the State experienced increases.

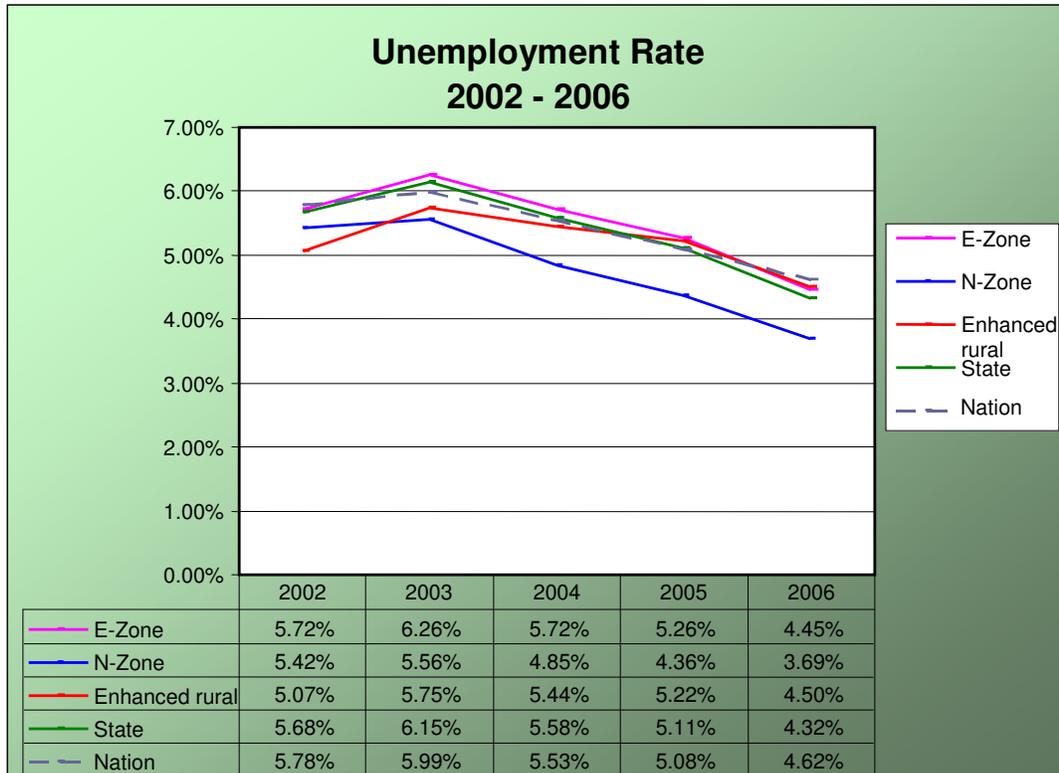
## Review of Six Economic Indicators

As previously discussed, statutes require the State Auditor to evaluate the Program's effect on six economic indicators. In the following sections, we discuss our findings relative to the following six economic indicators: *unemployment rate, employment, per capita income, investment, overall growth rate, and economic diversity*. In many cases, we compared zone, enhanced rural zone, non-zone, state, and national data. Our review generally focused on the five-year period from 2002 through 2006. We obtained input from the State Enterprise Zone Coordinator, the zone administrators, the Department of Labor and Employment, the Department of Revenue, and other sources in defining each of the six indicators.

Because complete census data were not available for the five-year period reviewed (2002-2006), we adapted our analysis accordingly. For example, data on the six economic indicators were not available at the zone level. Thus, the results presented in our analysis only reflect entire county data. Because many zones typically include more than one county, the zone data are the weighted average of all counties. This lack of data specific to the geographic area of the zones limits the conclusions that can be drawn about the impact of the Program to stimulate economic activity in these economically distressed areas. Additionally, the non-zone data are the average of the nine Colorado counties not included within an enterprise zone (Boulder, Broomfield, Douglas, Eagle, Gilpin, Park, Pitkin, Summit, and Teller counties). We again caution that a direct causal relationship cannot be established between implementation of the Enterprise Zone Program, or changes made to the Program, and changes, whether positive or negative, in the following economic indicators.

**Unemployment Rate** - *The total number of unemployed persons expressed as a percentage of the total civilian labor force. That is, the unemployment rate is the percentage of persons who are unemployed and actively seeking employment as compared with the total eligible civilian labor force.*

Overall, the unemployment rate for enterprise zones remained somewhat higher than the State and national unemployment rates between 2002 and 2005. In 2006 the unemployment rate for enterprise zones was slightly higher than the State but slightly less than the national rate, reflecting the improvement in state economic conditions. As the exhibit on page 12 shows, for enterprise zones, enhanced rural zones, non-zone areas, the State, and nation, the unemployment rate peaked in 2003 and as the economy improved, declined steadily over the next three years. Throughout the five-year period, as in the past, the non-zone areas had a significantly lower unemployment rate than both the enterprise zones and the State. In addition, improvements in the non-zones exceeded improvements at both the State and zone levels.

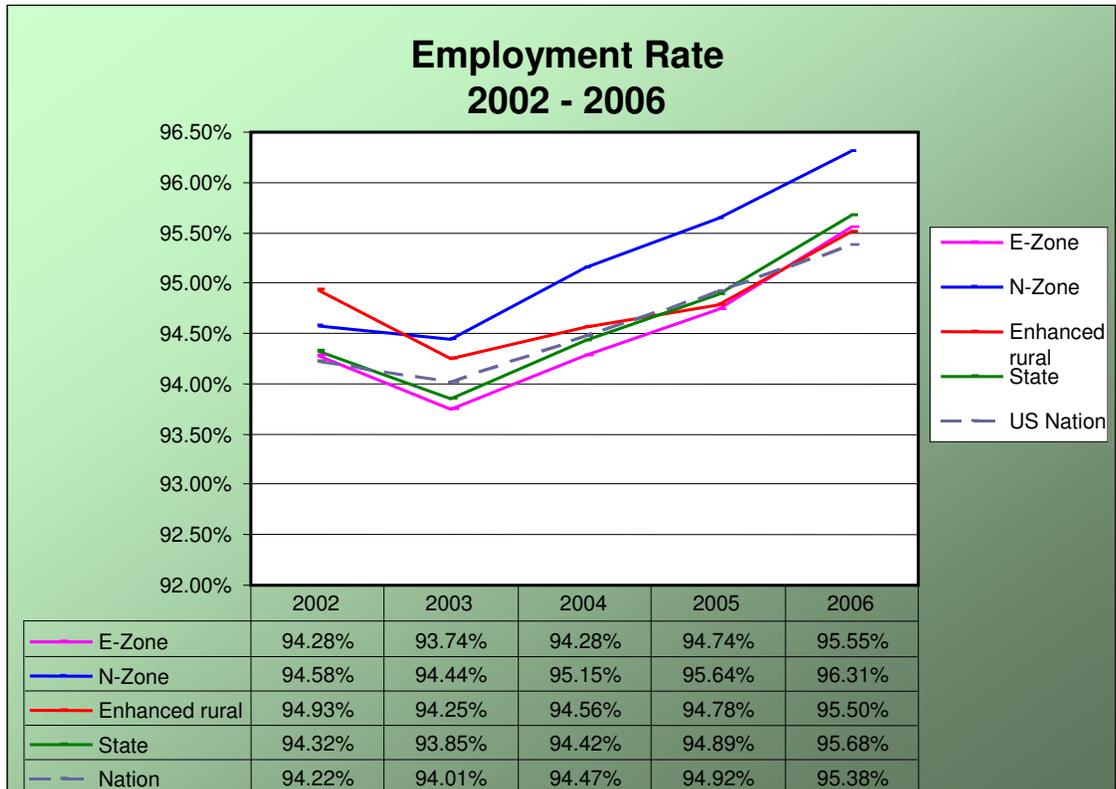


Source: Auditor analysis of Colorado Department of Labor and Employment data compiled by the Colorado Governor's Office of Economic Development and International Trade.

**Employment** - *The number of individuals in the civilian labor force, 16 or older, who are eligible to work and are actually employed. The civilian labor force is defined as the sum of employed and unemployed persons.*

In 2002, there were approximately 1.9 million employed individuals in the enterprise zone areas. In 2006, the number of employed persons had increased by more than 10 percent to about 2.1 million persons. For enhanced rural enterprise zones, the number of employed individuals increased from approximately 125,000 persons in 2002 to about 130,000 persons in 2005 or by about 4 percent. For the same time period, the number of employed individuals in the State increased from approximately 2.3 million to 2.5 million individuals, a growth of almost 9 percent.

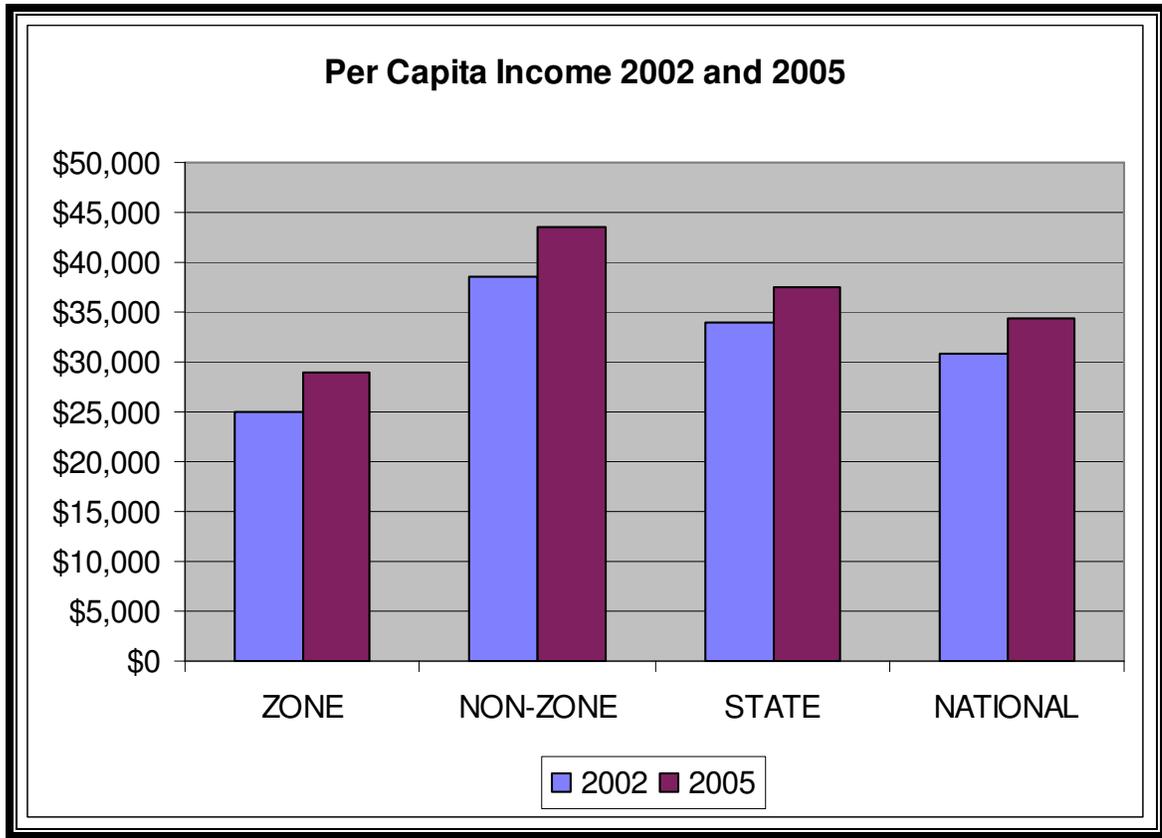
We also analyzed the employment rate, which is the percentage of the population employed, for enterprise zones, enhanced rural enterprise zones, non-zone areas, the State, and nation, and present the results in the exhibit on page 13. The employment rate for zones closely tracked the State and national rate from 2002 through 2006. The enhanced rural zones' employment rate in 2002 exceeded all others, decreased in 2003 and then closely tracked the rates for the enterprise zones, the State, and the nation between 2004 and 2006. During the same time period, the employment rate in the non-zone areas exceeded the rates for the enterprise zones, the State, and nation. Employment in all areas declined in 2003 and improved each year thereafter as the economy improved.



Source: Auditor analysis of data compiled by the Colorado Governor's Office of Economic Development and International Trade.

**Per Capita Income – The annual personal income of residents divided by the annual resident population.**

As the exhibit below illustrates, a significant difference in the average per capita incomes for the enterprise zones, enhanced rural enterprise zones, non-zone areas, the State, and nation persists. For 2002 and 2005, the average per capita income for enterprise zones increased an average of 16 percent from about \$25,000 to about \$29,000. Similarly, for the same time period, the average per capita income for enhanced rural enterprise zones increased an average of 15 percent from about \$22,400 to approximately \$25,700. However, the State's average per capita income was approximately \$37,500 in 2005, which is approximately \$8,500 more than the zones' average and \$11,800 more than the enhanced rural zones' average. The national average per capita income was about \$34,500 in 2005 or approximately \$5,500 more than the zone average and \$8,800 more than the enhanced rural zone average. Most significantly, the average per capita income for non-zone areas in Colorado was about \$43,500 in 2005 or approximately \$14,500 more than the zone average and \$17,800 more than the enhanced rural zone average. Although the enhanced rural enterprise zones saw an increase in average per capita incomes between 2002 and 2005, the per capita incomes remained the lowest of all geographic areas measured.



Source: Auditor analysis of per capita income data reported by the United States Bureau of Economic Analysis.

**Investment** - *The dollar amount of capital investments made by businesses in the zones. Investment amounts are partially reflected by the investment tax credits certified by local zone administrators.*

Increases occurred in capital investments and investment tax credits certified. Specifically:

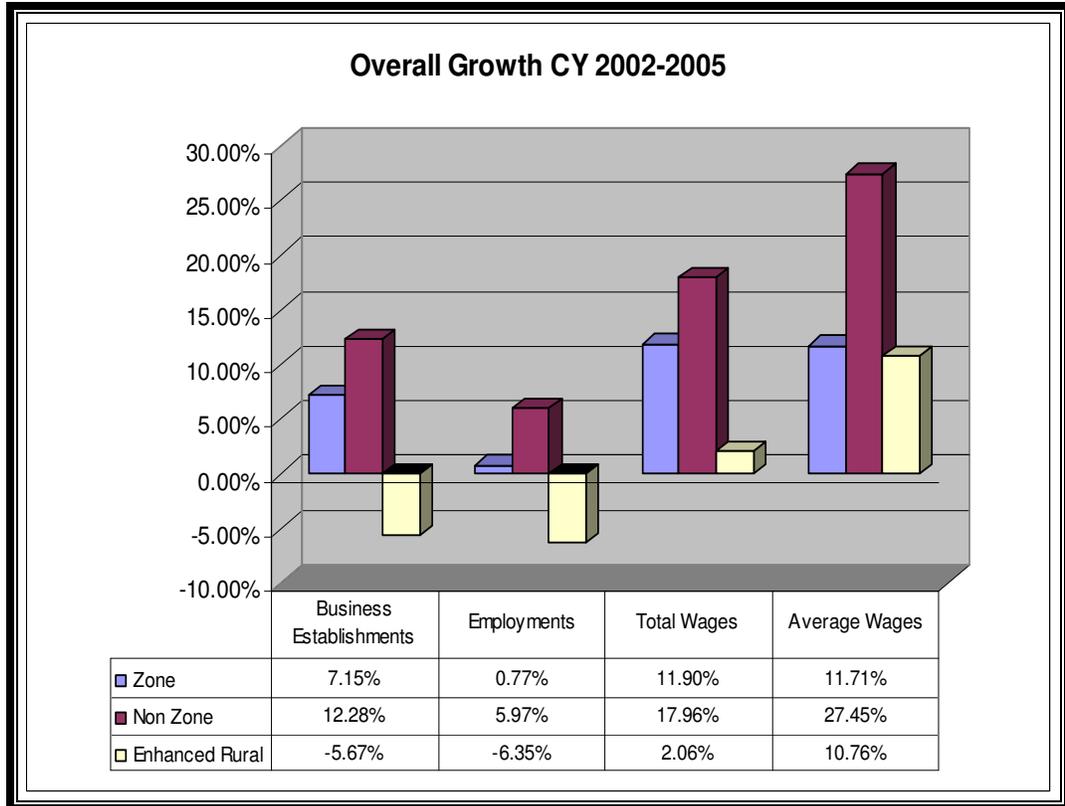
- **From 1997 to 2005, we estimate that capital expenditures by manufacturing businesses in enterprise zone counties increased by approximately 10 percent, from \$1.27 million in 1997 to \$1.4 million in 2005.** Nationally, capital expenditures during this period by manufacturing businesses declined by approximately 14 percent. Approximately 79 percent of the \$1.4 million in the capital expenditures made by manufacturing businesses within enterprise zones in 2005 consisted of machinery and equipment purchases, while the remaining 21 percent was attributable to buildings and other structures. Information relating to capital expenditures was limited, and as a result, the figures provided are based upon the best estimates available. Additionally, data were not available to estimate the amount of capital expenditures made by manufacturing businesses in enhanced rural enterprise zones.

- **Investment tax credits certified by zone administrators for Colorado businesses who invested in enterprise zones declined modestly from approximately \$40.1 million in Fiscal Year 2002 to almost \$36 million in Fiscal Year 2006.** According to enterprise zone certification information obtained from the Governor's Office of Economic Development and International Trade, more than \$221 million in investment tax credits were certified by zone administrators from Fiscal Years 2002 to 2006. These tax credits represent 3 percent of the total capital expenditures made by the businesses. This translates into about \$7.4 billion spent within enterprise zones on items such as machinery, furniture, appliances, and vehicles. (Data were not available to estimate the total capital expenditures made by businesses in enhanced rural enterprise zones.)

**Overall Growth Rate - *Changes in the number of business establishments and employees, as well as increases and decreases in wages paid.***

Overall, both zone and non-zone counties experienced increases in business establishments, employees, total wages, and average wages from 2002 to 2005 (most recent data available). In contrast, the enhanced rural zones experienced declines in the number of business establishments and employees during the same period. Additionally, although the enhanced rural zone counties experienced increases in total and average wages, the increases were slightly lower than those realized by both the zone and non-zone counties. The non-zone counties growth rate is higher than the zone counties growth rate in the number of business establishments, employments, total wages, and average wages. The rate of increase in these areas directly impacts opportunities for residents and those considering locating in an enterprise zone, which, in turn provides the workers and per capita income to support the businesses. According to the 2002 State Auditor's report, both the zone and non-zone counties experienced increases in business establishments, employees, and wages from 1996 to 2000. During that period the greatest increases were in total wages. This reflects the healthy economic conditions of the 1990s. The largest increases in the 2002 to 2005 period for zones were in total wages.

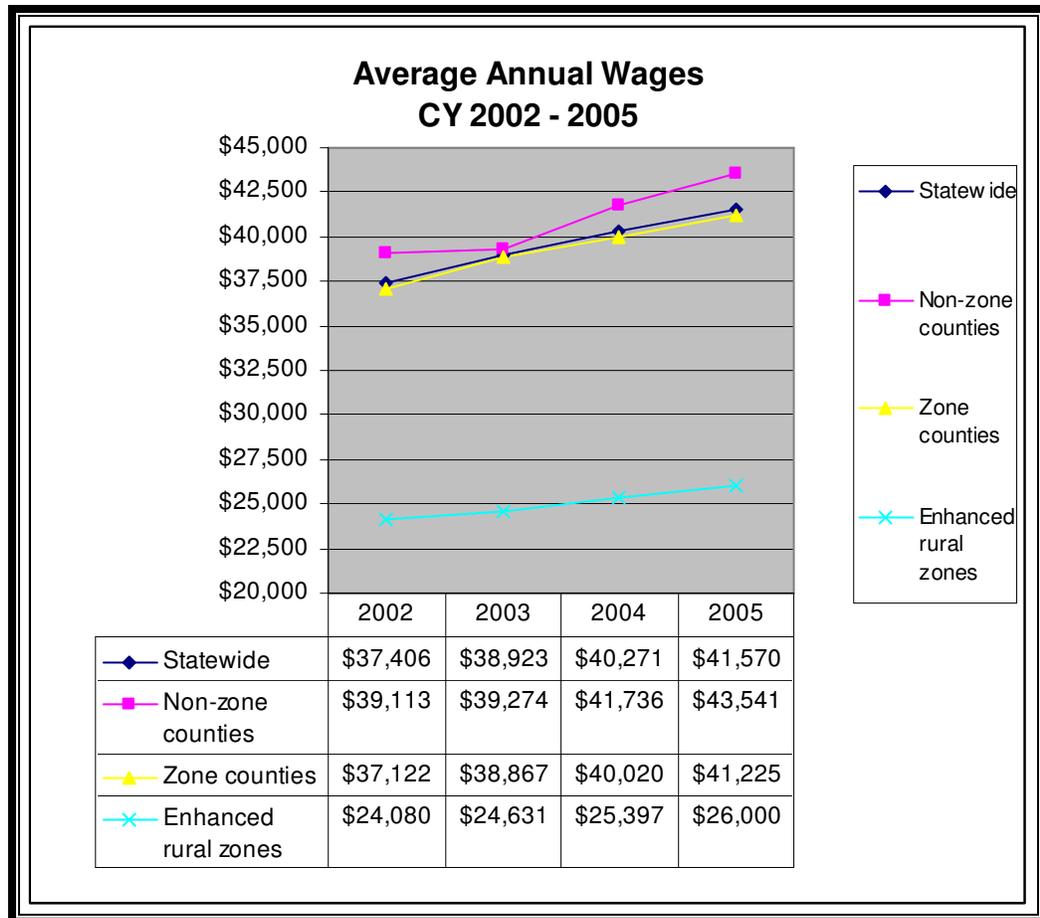
The following exhibit shows the percentage change in each of the categories for the zone, enhanced rural zones, and non-zone counties:



Source: Auditor analysis of Department of Labor and Employment Data.

The following observations regarding overall growth between calendar years 2002 and 2005 were made:

- Within zone counties, the communications industry experienced the largest declines in number of business establishments and employments (a loss of 139 businesses and 12,256 employees). However, the average wages for the communications industry in the zone counties increased by 7.7 percent over the period.
- From 1996 to 2000 the mining industry was the only private sector industry to experience a decline in the number of business establishments and employees in the zone counties. From 2002 to 2005 the industry experienced the greatest increase in employments, total wages, and average wages. The mining industry experienced a 14 percent increase in the number of business establishments, which is the second greatest increase in business establishments for all sectors in zone counties from 2002 to 2005.
- As illustrated in the exhibit below, the average wages reported for enterprise zone, enhanced rural enterprise zone, and non-zone counties and for the State as a whole increased between 2002 and 2005.



Source: Auditor analysis of Department of Labor and Employment data.

**Economic Diversity - *The variety or types of businesses in operation.***

In general, two or three industries represented more than one-half of the business establishments and employees in the zone and enhanced rural zone counties for the 2002 to 2005 period. This is consistent with the State Auditor’s prior analysis. Since the 2002 audit, the enterprise zones have not been able to attract a significant number of higher wage businesses that would, in turn, improve their economic conditions.

Among the types of businesses located in the zones and enhanced rural zones, the services and retail trade industries represented the largest percentage of businesses. Compared with other industries, such as manufacturing (which declined significantly in Colorado and in the nation as a whole since 2003 and has not rebounded to levels in the 1990s), transportation, communication, and public utilities, the services and retail trade industries paid among the lowest wages in the zone and enhanced rural zone counties during these years. For example, the average salary for a manufacturing position was approximately \$45,000 in 2006. By contrast, average salaries in the services and retail trades were \$36,400 and \$19,200, respectively. As the following exhibits show, the top five industries in terms of the percentage of total business establishments and employees remains relatively constant in the zone and enhanced rural zone counties.

**Top 5 Industries  
by Percent of Total Business Establishments  
CY 2002 and 2005**

Calendar Year 2002							Calendar Year 2005						
	Zone Counties		Non-zone Counties		Enhanced Rural			Zone Counties		Non-zone Counties		Enhanced Rural	
Rank	Industry	%	Industry	%	Industry	%	Rank	Industry	%	Industry	%	Industry	%
1	Services	38.50%	Services	41.54%	Services	28.19%	1	Services	39.23%	Services	42.22%	Services	27.93%
2	Retail	15.29%	Retail	14.92%	Retail	20.75%	2	Retail	15.28%	Retail	14.43%	Retail	21.42%
3	Construction	12.90%	Construction	14.44%	Construction	14.12%	3	Construction	12.55%	Construction	13.21%	Construction	14.12%
4	Finance, Insurance, & Real Estate	11.10%	Finance, Insurance, & Real Estate	10.58%	Government	11.08%	4	Finance, Insurance, & Real Estate	12.25%	Finance, Insurance, & Real Estate	11.54%	Government	11.76%
5	Wholesale	10.06%	Wholesale	10.22%	Finance, Insurance, & Real Estate	7.68%	5	Wholesale	9.46%	Wholesale	9.75%	Finance, Insurance, & Real Estate	7.27%
	Other*	12.15%	Other*	8.30%	Other*	18.18%		Other*	11.22%	Other*	8.85%	Other*	17.50%

Source: Auditor's analysis of the Employment and Wage Averages Annual Reports for 2002 and 2006.

Note: The sum of the percentages may be more or less than 100 percent due to rounding.

\*) Other includes Agriculture; Mining; Manufacturing; Transportation; Communication & Public Utilities; and Government.

**Top 5 Industries  
by Percent of Total Employees  
CY 2002 and 2005**

Calendar Year 2002							Calendar Year 2005						
Rank	Zone Counties		Non-zone Counties		Enhanced Rural		Rank	Zone Counties		Non-zone Counties		Enhanced Rural	
	Industry	Percent	Industry	Percent	Industry	Percent		Industry	Percent	Industry	Percent	Industry	Percent
1	Services	29.58%	Services	32.36%	Government	34.58%	1	Services	30.64%	Services	33.58%	Government	36.97%
2	Retail	16.76%	Retail	21.31%	Retail	20.62%	2	Retail	16.94%	Retail	21.60%	Retail	20.66%
3	Government	16.17%	Government	13.32%	Services	17.84%	3	Government	16.28%	Government	13.21%	Services	16.55%
4	Manufacturing	8.82%	Manufacturing	11.64%	Construction	5.99%	4	Manufacturing	8.00%	Manufacturing	9.72%	Construction	5.85%
5	Construction	7.37%	Construction	7.88%	Agriculture	5.52%	5	Finance, Insurance, & Real Estate	7.61%	Construction	7.58%	Agriculture	5.68%
	Other*	21.29%	Other*	13.49%	Other**	15.45%		Other***	20.52%	Other*	14.31%	Other**	14.29%

Source: Auditor analysis of the Employment and Wage Averages Annual Reports for 2002 and 2005.

Note: The sum of the percentages may not equal 100% due to rounding.

\*) Other includes Agriculture; Mining; Transportation; Communication & Utilities; Wholesale; and Financial, Insurance, & Real Estate.

\*\*\*) Other includes Mining; Manufacturing; Transportation; Communication & Utilities; Wholesale; and Financial, Insurance, & Real Estate.

\*\*\*\*) Other includes Agriculture; Mining; Construction; Transportation; Communication & Utilities; and Wholesale.

## Achievement of Zone Objectives

By statute, each enterprise zone is to adopt specific economic development objectives with outcomes that can be measured with specific, verifiable data. Section 39-30-103, C.R.S., requires the State Auditor, as part of the audit, to evaluate the effectiveness of each zone in achieving its objectives. The following describes the findings of our current review of the zones' objectives identified in their 2006 annual reports. Of the 82 total objectives identified by the zones, we were unable to evaluate 50 because the objectives were not measurable or there was insufficient data to determine whether or not the objectives had been achieved. Additionally, we found that three of the 16 zones (about 19 percent) failed to include at least one measurable objective in their 2006 annual reports, as required by statute.

Of the 32 objectives that could be assessed, the zones reported that they were unsuccessful in achieving the majority of them. Specifically, the zones reported that:

- Seventeen (53 percent) of the 32 objectives had *not* been achieved.
- Thirteen (41 percent) of the 32 objectives had been achieved.
- Two (6 percent) were not yet scheduled to be met.

To further understand the relationship between the objectives that were achieved and those that were not, we grouped the 32 measurable objectives into three broad categories: (1) economic conditions - objectives aimed at improving the economic conditions of zone areas such as increase per capita income, lower the unemployment rate, and create more jobs; (2) community conditions - objectives directed toward improving the community as a whole (e.g., reduce the number of people living below poverty, or increase community well-being); and (3) administrative actions - objectives that addressed the administrative actions of the zones (e.g., identify the number of businesses in the zone, increase marketing efforts, and develop new marketing materials).

Overall we found that of the 32 measurable objectives, 26 (81 percent) addressed economic conditions, 4 addressed administrative actions, and 2 addressed community conditions. Specifically:

- Of the 13 objectives that were reported as achieved, 12 addressed economic conditions, one addressed administrative actions, and none of the achieved objectives addressed community conditions. Examples of the economic objectives include achieving an annual growth rate in new equipment investments to exceed 10 percent over the previous year's total and ensuring that at least 50 percent of new jobs gained in the area are located within the enterprise zone.

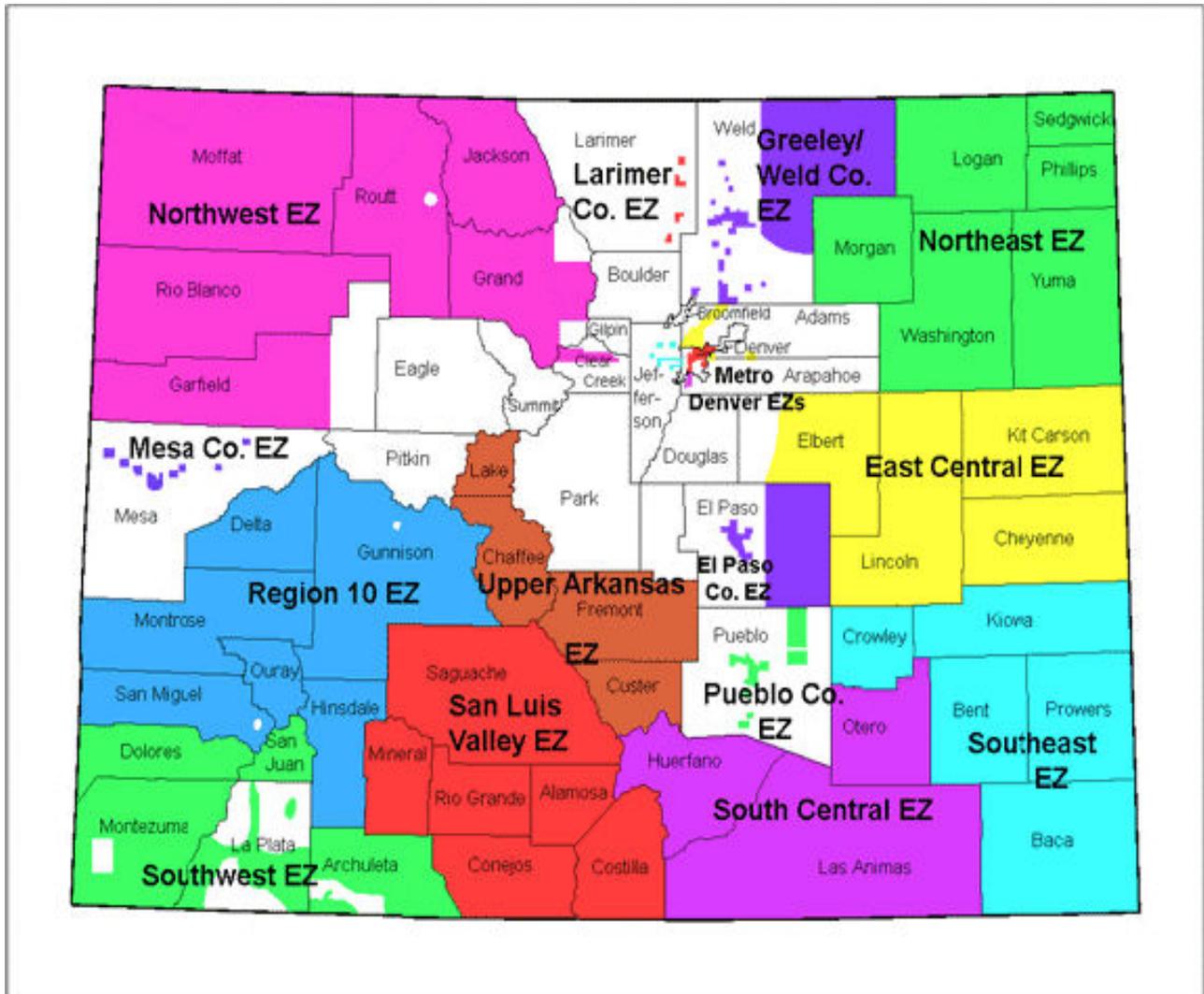
- Of the 17 objectives that were *not* achieved, 13 addressed economic conditions, two addressed community conditions, and two addressed administrative conditions. An example of an economic objective that was not achieved includes that the average per capita income for each of the counties within the enterprise zone should be equal to or greater than the State's average per capita income.

Just as a direct causal relationship between the Program and changes in the overall economic conditions of zone areas cannot be established, it is not possible to determine whether the Program alone is responsible for the achievement of individual zone objectives. In the case of the objectives that were not achieved, generally these contained aggressive or high benchmarks, or the zone simply did not experience the improvements in the economic conditions anticipated at the time the objectives were adopted.

Though there has been some improvement by the enterprise zones in developing their objectives, issues that were noted in previous audit reports continue. As such, we reiterate the State Auditor's 2002 recommendation that the Department of Local Affairs continue to work with the zones to refine economic development objectives by providing timely review and feedback as part of the Department of Local Affairs' annual report preparation process (see Recommendation No. 1 in Appendix B).

# Appendix A

Colorado Enterprise Zone Map



# Appendix B

## Disposition of 2002 Performance Audit Recommendations As of November 2007

Section 39-30-103(4)(c)(II), C.R.S., requires the State Auditor to audit the Enterprise Zone Program no less than once every five years. In November 2002 the State Auditor issued a report evaluating the implementation of the Program and the Program's impact on six economic indicators: employment, unemployment rate, investment, overall growth rate, economic diversity, and per capita income. Also, the audit included a review of the annual report prepared by the Executive Director of the Department of Local Affairs summarizing documentation provided by the individual enterprise zones concerning efforts to achieve their respective economic development objectives.

In the 2002 audit, the State Auditor made five recommendations, including three to the Department of Local Affairs, one to the Department of Revenue, and one to both the Departments of Local Affairs and Revenue. As the following sections indicate, during the 2007 audit we found that both recommendations made to the Department of Revenue were implemented and that the Department of Local Affairs fully or partially implemented the three recommendations it agreed to implement during the 2002 audit. In 2002, the Department of Local Affairs disagreed with one recommendation regarding the authority for some zone administrators to charge fees on the contribution credit (see Recommendation No. 3).

<b>Department of Local Affairs Performance Audit November 2002</b>	
<b>No. 1:</b> The Department of Local Affairs should continue to work with the zones to refine economic development objectives by providing timely review and feedback as part of the Department's annual report preparation process.	
<b>Department of Local Affairs Response:</b> Agree <b>Implementation Date: Ongoing</b>	
Agency Update	State Auditor Evaluation
The Department has provided guidance to the zones in developing their economic development objectives. The guidance has been provided at the bi-annual enterprise zone administrator meetings, as well as in memos and phone conversations. Additionally, the Department continues to view the Enterprise Zone Program as a locally driven program and believes that objectives should be determined by local officials.	<b>Implemented.</b>

**Department of Local Affairs  
Performance Audit  
November 2002**

**No. 2:** The Department of Local Affairs should ensure zones' marketing efforts are improved by: (a) identifying best practices and providing technical assistance and guidance to the zones in educating and informing the businesses in their area about the Program; (b) working with the Department of Revenue to establish an annual list of businesses in each zone for use by zone administrators in notifying and educating businesses about zone credits; and (c) assisting zones in recruiting contribution projects that are appropriate to their local economic development goals and objectives.

**Department of Local Affairs Response:  
Partially Agree  
Implementation Date: December 2003**

Agency Update	State Auditor Evaluation
<p>(a) Most enterprise zones have found that marketing to tax preparers is very effective in reaching the business community. Zone administrators are familiar with organizations operating in their areas that can help further the zone's economic goals. Zone administrators share marketing efforts with each other at bi-annual meetings. The Department continues to assist in identifying best practices and providing technical assistance and guidance to zones regarding marketing efforts.</p> <p>(b) The Department inquired whether the Department of Revenue could create a list of businesses to distribute to zone administrators. The Department of Revenue could not provide the Department or the zone administrators with such information.</p> <p>(c) Information about contribution projects received by the Department is shared with all zone administrators.</p>	<p><b>Implemented.</b></p>

**Department of Local Affairs & Department of Revenue  
Performance Audit  
November 2002**

**No. 3:** The Department of Local Affairs should work with the Department of Revenue to determine if fees should be charged on the contribution credit. If it is determined that such fees should be charged, the Department of Revenue should amend its regulations or seek statutory changes to: (a) authorize the levying of fees under Section 39-30-103.5, C.R.S., for contributions credits and (b) establish criteria for determining the reasonableness of such fees.

**Department of Local Affairs Response:**

**Disagree**

**Implementation Date: N/A**

**Department of Revenue Response:**

**Agree**

**Implementation Date: May 2004**

Agency Update	State Auditor Evaluation
<p><b><u>Department of Local Affairs response:</u></b> In the 2002 audit response, the Department of Local Affairs disagreed with this recommendation and stated various reasons for not agreeing. The Department has informally researched the authority for zone administrators to charge fees and found that the Department had no statutory authority to determine whether or not charging fees by local governments and/or non-profit entities was authorized, in addition to not having specified enforcement powers regarding this item. As such, the Department continues to disagree with this recommendation.</p> <p><b><u>Department of Revenue Response:</u></b> The fees for contributions were assessed by some local enterprise zone administrators to pay the expenses of the Enterprise Zone Program in their area. The fees were supported by the Department's regulations that were drafted years ago despite not being mentioned in statute. As a result of the auditor's report, we revised the regulations to delete all reference to the fee. The fee issue itself was to be addressed by the Department of Local Affairs.</p>	<p><b>Department of Local Affairs – Not Implemented. Department of Revenue – No longer applicable.</b></p>

**Department of Local Affairs  
Performance Audit  
November 2002**

**No. 4:** The Department of Local Affairs should work with the zone administrators to ensure contributors are notified of all enterprise zone program fees.

**Department of Local Affairs Response:**

Agree

**Implementation Date: July 2003**

Agency Update	State Auditor Evaluation
<p>The Department recently polled zone administrators to determine who is charging fees. Some zones charge fees to cover their administrative costs, while others do not. For those charging fees to non-profit organizations, many zone administrators disclose this on the certification form provided to the contributor. The Department will renew efforts to have zone administrators inform contributors of any fees charged.</p>	<p><b>Partially Implemented.</b> The Department has made some progress in implementing this recommendation. As of October 2007, 7 of the 16 enterprise zones continue to charge a fee for processing the contribution credit. We found that only 3 of the 7 zones charging fees consistently notify the contributor of the fee. The Department has agreed to continue to work on this item and will make a written request to all zone administrators asking that they submit revised certification forms reflecting this disclosure by no later than January 31, 2008.</p>

**Department of Revenue  
Performance Audit  
November 2002**

**No. 5:** The Department of Revenue should improve controls over enterprise zone tax credit eligibility by: (a) ensuring that taxpayers are eligible for the credits taken; (b) processing only complete returns or evaluating methods of ensuring that accurate credits are claimed should the taxpayer fail to submit the required certification; and (c) evaluating the cost-benefit of conducting targeted audits of the enterprise zone tax credits.

**Department of Revenue Response:**

**(a) Agree, (b) Partially Agree, (c) Agree**

**Implementation Date: December 2003**

Agency Update	State Auditor Evaluation
<p>(a) Edits to verify supporting documentation for credits claimed relating to enterprise zones were implemented for paper filings in Tax Year 2003 and for electronic filings in Tax Year 2004.</p> <p>(b) Implemented edits so that returns lacking the enterprise zone certification form are denied, and the returns are adjusted before processing. Hence, returns with enterprise zone credits must be complete to receive the credit.</p> <p>(c) The Field Audit Section generated an initial list of all individual and corporate taxpayers claiming Enterprise Zone credits during the prior year. From this list, the section chose 31 audits to conduct to determine if the Enterprise Zone credit claimed was a useful indicator of dollars at risk.</p> <p>Of the initial 31 audits, 27 were completed and 4 remain in inventory. The Section also completed 20 audits derived from subsequent years' lists. The 47 completed audits with Enterprise Zone credits resulted in total assessments of \$863,000 and required 4,758 hours to complete, for a dollar per hour average of \$181. However, on further analysis, we found that only 2 of the 47 audits yielded more than half of the audit assessments, and the remaining 45 audits yielded an average of well under our target of \$150 per audit hour for in-state travel audits, with an average audit return of \$92 per audit hour.</p> <p>As a result, the Section will continue to generate the list of Enterprise Zone credit taxpayers annually, and consider Enterprise Zone credits in audit selection, along with other known predictors of tax liability. Based on the results of our analysis to date, we believe that Enterprise Zone credits may be a valuable supplemental data point in evaluating potential audits, but not a single determinant of the need for an audit.</p>	<p><b>Implemented.</b></p>

# Appendix C

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## Colorado Enterprise Zone Program Legislative History

### **1986 – Senate Bill 86-95 (Original Urban and Rural Enterprise Zone Act):**

- Provided for a “pilot program” of eight zones.
- Established eligibility criteria for zone designation, including high unemployment, low per capita income, and slow population growth, as compared to the state average for each criteria.
- Original tax credits included an investment tax credit, new business facility employee credit, and a higher ceiling for manufacturing equipment sales and use tax exemption than the statewide limit in effect at the time.
- Program scheduled to sunset in 1990.

### **1987 – House Bill 87-1274:**

- Amended statute to allow for the designation of four additional zones, with two to be designated in 1987 and two in 1988. This brought the total allowable zones to 12.
- Provided for additional tax credits and incentives, including a health insurance new jobs credit, agricultural processing new jobs credit, and authorized local governments to offer additional property and sales tax incentives.
- Extended Program sunset to 1995.

### **1987 – House Bill 87-1331:**

- Beginning January 1, 1988, made machinery-purchase tax credit available regardless of monetary amount.

### **1988 – Senate Bill 88-31:**

- Provided for an additional research and development tax credit.

### **1989 – House Bill 89-1349:**

- Authorized credits for contributions made to economic development projects and for rehabilitating older, vacant buildings.
- Extended the new business facility employee tax credit to expanding businesses.
- Program sunset changed to 1994.

**1990 – House Bill 90-1171:**

- Amended statute to allow for the designation of four additional zones. This brought the total allowable zones to 16.
- Extended Program sunset to 1998.

**1990 – Senate Bill 90-161:**

- Authorized tax credit for contributions to child care facilities.

**1991 – Senate Bill 91-131:**

- Sales and use tax exemption for manufacturing machinery extended to mining equipment in enterprise zones.

**1991 – House Bill 91S-1005:**

- Removed sunset clause. The Enterprise Zone Program became a permanent state economic development program. The General Assembly removed the sunset clause to encourage long-term business investments in enterprise zones.

**1992 – House Bill 92-1026:**

- New business facility employee credit made non-refundable and allowed the credit to carry forward for up to five years.

**1994 – House Bill 94-1163:**

- Truck drivers based in enterprise zones treated as if working full time in zone for purposes of calculating the new business facility employee credit.

**1994 – Senate Bill 94-64:**

- Authorized additional credit for contributions made to homeless employment support services programs.

**1994 - Senate Bill 94-182:**

- Authorized any county, city or municipality to negotiate with any qualifying taxpayer for a tax credit or incentive payment.

**1995 - House Bill 95-1028:**

- Made purchases of machinery or tools for use in manufacturing in excess of \$500.00 tax exempt.

**1995 - Senate Bill 95-221:**

- Authorized any county, city or municipality to negotiate with new or expanding businesses for (1) any tax credit or incentive payment, and (2) a sales tax refund on new machinery or tools.

**1996 – Senate Bill 96-193:**

- Shifted authority over zone boundary changes from the Department of Local Affairs to the Economic Development Commission.
- Provided the Economic Development Commission with the authority to terminate non-qualifying zone areas.
- Expanded the maximum population allowed in each zone from 50,000 to 80,000.
- Reduced the contribution tax credit from 50 percent of contribution to 25 percent.
- Required the Economic Development Commission to annually review all proposed contribution projects.
- Restricted contribution projects to those projects directly related to job creation or preservation.
- Authorized a new 10 percent credit for investments in employee job training programs located in zones and a 10 percent credit for enterprise zone employer school-to-work expenses.
- Extended the carry-forward periods for unused investment tax credits and the new business facility employee health insurance credits.
- Added a number of reporting requirements for local zone administrators and created transition mechanisms to phase out tax credits from taxpayers located in terminated areas and resulting from the reduction in the contribution credit.

**1997 – House Bill 97-1152:**

- The 10 percent school-to-work credit was made available to employers statewide.

**1998 – Senate Bill 98-7:**

- Made the contribution credit to homeless employment support services programs permanent. The credit was originally intended to expire in 1998.

**1998 – Senate Bill 98-154:**

- The 25 percent credit for contributions to promote child care was expanded statewide.

**1999 – Senate Bill 99-033 (Legislative Audit Committee Bill):**

- Established a minimum 5-year cycle for zone boundary review by the Economic Development Commission, beginning with the availability of 2000 Census socioeconomic data.

- Authorized the Economic Development Commission to only review new or modified proposals for designation as an enterprise zone contribution project, rather than annually re-approving all projects.
- Increased enterprise zone reporting requirements.
- Beginning September 1, 2001 and every two years thereafter, required the State Auditor to review the Department of Local Affairs' annual report to the General Assembly.
- Required the State Auditor to evaluate the implementation and effectiveness of the Program at least every five years.

**2000 – Senate Bill 00-99 (Office of Economic Development Reorganization Bill):**

- Created the Colorado Office of Economic Development within the Governor's Office.
- Transferred the rights, powers and functions of the Economic Development Commission, which was located within the Department of Local Affairs, to the Colorado Office of Economic Development.
- Created the Colorado Economic Development Commission within the Colorado Office of Economic Development.
- Authorizes the Colorado Office of Economic Development to execute certain functions related to enterprise zone designation.

**2002 – House Bill 02-1161:**

- Created Enhanced Rural Enterprise Zones.
- Authorized increased tax credits for the new business facility employee and agricultural new business facility employee credits for businesses located in counties within existing enterprise zones and meeting specified criteria.
- Increased maximum population limit within rural enterprise zones from 80,000 to 100,000.
- Added "community development" as a category of projects which are eligible for the contribution tax credit.
- Made enterprise zone certification forms completed by taxpayers public records.
- Created a new-business tax credit for Enhanced Rural Enterprise Zones.

**2002 – House Bill 02-1399:**

- Repealed requirement that within 12 months after the release of 2000 Census socioeconomic data and every five years thereafter, that the Department of Local Affairs establish criteria, procedures, and a termination schedule for zones that no longer meet the criteria.
- Repealed the requirement that the Colorado Economic Development Commission terminate zones based on recommendations by the Department of Local Affairs.
- Extended maximum period that credits earned by taxpayers in terminated areas could be used to 10 years.

**2004 - Senate Bill 04-003:**

- Eliminated the requirement that the Office of the State Auditor conduct a two year review of the Department of Local Affairs' annual report and added a requirement that the Department of Local Affairs make an annual presentation to the Legislative Audit Committee reviewing and summarizing the information contained in the Department of Local Affairs' annual report.

**2005 - House Bill 05-1048:**

- Limited a Special District's ability to enter into an agreement for a rehabilitation of vacant buildings tax credit to instances when the taxpayer enters into such an agreement with the municipality.

**2007 - House Bill 07- 1027:**

- Made the economic development contribution tax credit available beginning January 1, 1989. The credit was formerly available beginning January 1, 2000.

**2007 - House Bill 07-1312:**

- Made the new business facility employee tax credit available to the business where the employee worked, even if an employee leasing company withheld the taxes from that employee's paycheck.

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