1981

The Kemp-Garcia Enterprise Zone Bill: A New, Less Costly Approach to Urban Redevelopment

Robert W. Benjamin

Follow this and additional works at: https://ir.lawnet.fordham.edu/ulj

Part of the Tax Law Commons

Recommended Citation
Available at: https://ir.lawnet.fordham.edu/ulj/vol9/iss3/13

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Urban Law Journal by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.
THE KEMP-GARCIA ENTERPRISE ZONE BILL: A NEW, LESS COSTLY APPROACH TO URBAN REDEVELOPMENT

This Comment discusses the Kemp-Garcia "Urban Jobs and Enterprise Zone" bill introduced in Congress on June 12, 1980. The bill is currently being revised, and several drafts of the proposed legislation are anticipated.

I. Introduction

One of the many domestic problems facing the Reagan Administration is the plight of the nation's poorest urban areas. The President has indicated that he favors the redevelopment of such areas through the creation of enterprise zones. Enterprise zone proposals come in many forms, but generally an enterprise zone is a small area, such as an inner-city neighborhood, which offers tax abatements and other incentives to businesses willing to locate within the boundaries of the zone. The zones are intended to rebuild economically depressed areas with private capital rather than public funds.

1. President Reagan began endorsing enterprise zones during the 1980 Presidential campaign. At the Republican National Convention, the delegates adopted a plank in the party platform which pledged that as part of a Republican effort to revitalize neighborhoods "[l]ocal government will be invited to designate specific depressed areas as jobs and enterprise zones." Republican National Convention, Platform (1980), reprinted in 126 Cong. Rec. S10379, 10385 (daily ed. July 31, 1980). In the nationally televised Presidential debate of 1980, Reagan emphasized his support for enterprise zones:

I have been talking to a number of Congressmen who have much the same idea that I have. And that is that in the inner-city areas, that in cooperation with local government and with national government and using tax incentives and with cooperation with the private sector, that we have development zones. Let the local entity, the city, declare this particular area based on the standards of the percentage of people on welfare, unemployed and so forth in that area. And then, through tax incentives, induce the creation of businesses providing jobs and so forth in those areas.


2. Enterprise zones are not without their costs to the public. The initial loss of tax revenues due to exemptions is borne by non-exempt taxpayers. Supporters of enterprise zones argue, however, that tax payments by businesses in depressed neighborhoods are already low and, furthermore, that all initial losses will be recouped with the addition of new businesses and employees to the tax rolls. Butler, For 'Enterprise Zones', N.Y. Times, June 13, 1980, at A29, col. 3. Another cost to the public is the funding of the bureaucracy which attends every government program. See note 229 infra and accompanying text for a cost analysis of the enterprise zone bill now before Congress.
The idea of using tax incentives to spur the growth and development of particular industries is not a new one. What distinguishes the enterprise zone proposals of today, though, from past tax incentive statutes is the grand scale of the new programs. For the first time, the federal government would provide major incentives to encourage the private sector to undertake the herculean task of rebuilding the nation's most impoverished areas. That task has been assumed by federal and local governments in recent years through the implementation of such well intended, but not always successful, programs as urban renewal and model cities. Proponents of enterprise zones contend that government can no longer perform the task alone.

Enterprise zones were first proposed in Great Britain in the late 1970's. They grew out of a "Freeport" model conceived by a socialist professor of urban planning, Peter Hall, who believed that permitting "fairly shameless free enterprise" in abandoned neighborhoods would result in the rebuilding of those neighborhoods. Sir Geoffrey Howe, now Chancellor of the Exchequer, suggested that the Freeport model be tested in high unemployment areas throughout Britain in what he called "enterprise zones." As proposed by Sir Geoffrey, enterprise zones were designed to free resident businesses of as many government controls as possible. The

---

3. Previous tax incentives designed to stimulate private enterprise are discussed in section III. See notes 68-153 infra and accompanying text.

4. President Reagan dramatically illustrated his belief that industry must play a leading role in the rebuilding of cities when, during the 1980 campaign, he returned to the same South Bronx street that President Carter had visited three years earlier. Noting the failure of federal funds to produce any visible results in the devastated neighborhood, Reagan indicated that he favored the use of tax incentives to encourage private enterprise to rebuild the area. N.Y. Times, Aug. 6, 1980, at A16, col. 4.


6. Id. at 22. Hall viewed his Freeport model as a "nonplan" involving three central elements: 1) free trade with a prohibition against sales taxes and duties on foreign goods; 2) free enterprise with limitations on regulations, taxes, and social services; and 3) free choice of residence with existing residents welcome to stay, and enjoy low taxes but few social services, or to leave. Hall saw the model as an "'extremely drastic last-ditch solution'" to be attempted only in areas "'largely abandoned and denuded of people.'" Id.

7. Id.

8. For example, businesses located in enterprise zones under this plan would not be subject to wage and price controls, property taxes, zoning laws, or rent control. Id. at 23-24.
sites for the first enterprise zones in Britain were announced in 1980.⁹

The idea was exported to America, where Representative Jack Kemp introduced the first enterprise zone bill in Congress on May 1, 1980.¹⁰ A second bill, which was co-sponsored by Representative Robert Garcia, followed on June 12, 1980.¹¹ The express purpose of the Kemp-Garcia bill is to “amend the Internal Revenue Code of 1954 to provide certain tax incentives for individuals and businesses in depressed areas.”¹² Unlike the British program, the bill would not relieve resident businesses of any of their responsibilities to maintain environmental, safety, minimum wage, or fair labor standards.¹³ It relies instead on the notion that a favorable tax structure will be sufficient to induce new businesses to locate in areas designated as enterprise zones.¹⁴

The Kemp-Garcia bill provides, in general, that enterprise zones are to be designated by the Secretary of Commerce at the request of state and local governments.¹⁵ To qualify, an area must have an especially high rate of unemployment or a large percentage of families living below the poverty level.¹⁶ In addition, the bill requires

---

12. Id.
14. Rep. Garcia, in urging Congress to pass the bill, stated:
Safety and health standards would be maintained, of course, as would all existing social programs and regulations. The hope of this legislation, however, is that as the depressed areas encounter enhanced economic opportunities the residents of those areas will be able to get off the welfare rolls and onto the payrolls.
local governments to make a permanent reduction in the real property tax rate in a zone.\textsuperscript{17} Once an area qualifies as an enterprise zone, the federal government reduces not only social security taxes for most employers and employees\textsuperscript{18} but also taxes on capital gains and corporate income.\textsuperscript{19} Further, certain businesses may take advantage of accelerated depreciation schedules,\textsuperscript{20} cash methods of accounting,\textsuperscript{21} and extensions of net operating loss carryovers.\textsuperscript{22} Each enterprise zone would be in effect for a period of ten years following its approval by the Secretary of Commerce.\textsuperscript{23}

Section II of this Comment will examine the bases of authority for the proposed Kemp-Garcia tax abatements and discuss the constitutional requirements imposed by state and federal uniformity and equal protection clauses. Section III will investigate previous tax incentives designed to stimulate private enterprise. Section IV will examine the particulars of the Kemp-Garcia bill itself. Finally, in section V, recommendations will be offered for consideration of this or any future enterprise zone legislation.

\textbf{II. Underlying Authority for the Legislation: The Power to Exempt}

The Kemp-Garcia bill would make available several tax incentives to all qualified businesses located in an enterprise zone.\textsuperscript{24} Congress would provide most of the incentives by amending the Internal Revenue Code to provide these businesses with tax abatements, but local governments would also have to do their share by reducing real property tax rates in the zone.\textsuperscript{25} While the bill is certainly open to political attack as a plan which would benefit individual businesses more than workers from within the community,\textsuperscript{26}

\begin{footnotes}
\item[18] H.R. 7563, tit. IIA, sec. 201. See notes 188-98 \textit{infra} and accompanying text.
\item[19] H.R. 7563, tita. IIB-IIC. See notes 199-217 \textit{infra} and accompanying text.
\item[20] H.R. 7563, tit. IID, sec. 231. See notes 218-22 \textit{infra} and accompanying text.
\item[22] H.R. 7563, tit. IID, sec. 233. See notes 226-28 \textit{infra} and accompanying text.
\item[24] H.R. 7563, tit. II. See notes 187-230 \textit{infra} and accompanying text.
\item[26] The Kemp-Garcia bill has already been opposed by New York City Councilman Gil-\end{footnotes}
the proposed legislation is far less vulnerable on constitutional grounds.

The power of a legislature to grant tax abatements stems from its powers to tax and to exempt. A tax abatement is actually a partial exemption, although the statutes vary in the language they use. Exemptions have often been challenged on constitutional grounds, particularly under federal and state uniformity and equal protection clauses. The abatements proposed by the Kemp-Garcia bill would similarly be subject to the constitutional standards which have developed under these clauses.

A. Compliance with the Uniformity Clause

The United States Constitution provides, that "all Duties, Imposts and Excises shall be uniform throughout the United States." Many state constitutions contain similar uniformity clauses which apply to certain taxes within the state. In each instance, it is important to examine closely the particular uniformity clause because its scope and meaning may not be readily apparent. For example, the uniformity clause in the federal Constitution must be read in conjunction with several other constitutional pro-

27. See, e.g., Mobile and O.R.R. v. Tennessee, 153 U.S. 486 (1894), in which the Supreme Court sustained a state tax exemption for a particular railroad by recognizing, first, the legislature's constitutional authority to grant an exemption, and second, "that such exemption might confer either total or partial immunity from taxation, and extend for any length of time the legislature might deem proper." Id. at 499.

28. Compare, e.g., the Kemp-Garcia bill which speaks in terms of tax "reductions," H.R. 7563, tit. II, with Puerto Rico's Industrial Incentive Act of 1978, P.R. LAWS ANN. tit. 13, § 255b, which speaks in terms of "partial exemptions." In each instance, eligible businesses are not taxed at the full rate.

29. See notes 36-66 infra and accompanying text.


31. See, e.g., ILL. CONST. art. 9, §§ 2, 4 (both property and non-property taxes must be reasonable and uniform within each class); Mich. Const. art. 9, § 3 (all taxes, whether or not imposed on property, must be applied uniformly); N.J. Const. art. 8, § 1, ¶ 1(a) ("Property shall be assessed for taxation under general laws and by uniform rules"); Ohio Const. art. XII, §§ 2-3 (unexempted real property must be taxed uniformly; income taxes "may be either uniform or graduated"); cf. N.Y. Const. art. 16 (article on taxation which contains no express uniformity clause); CAL. CONST. art. 13 (also without express uniformity clause).
visions. Sections two and nine of Article I require that direct taxes be apportioned among the states on the basis of total population.\textsuperscript{32} The language immediately preceding the uniformity clause indicates that while Congress has the authority to lay both direct and indirect taxes (the latter being those in the form of duties, imposts, and excises), it is bound by a rule of uniformity only when imposing indirect taxes.\textsuperscript{33} The distinction prompted the Supreme Court in \textit{Pollock v. Farmers' Loan and Trust Co.}\textsuperscript{34} to conclude, "the Constitution recognizes the two great classes of direct and indirect taxes, and lays down two rules by which their imposition must be governed, namely: The rule of apportionment as to direct taxes, and the rule of uniformity as to duties, imposts and excises."\textsuperscript{35} The problem for the courts, of course, has always been one of classification. The courts have repeatedly labored over the subtle differences between direct and indirect taxes in order to determine which rule to apply.\textsuperscript{36}

32. U.S. Const. art. I, § 2, cl. 3 provides: "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers. . . ." U.S. Const. art. I, § 9, cl. 4 provides: "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." It is significant that in each clause a specific reference to direct taxes was made.

33. U.S. Const. art. I, § 8, cl. 1 provides in full: "The Congress shall have Power To lay and collect Taxes, Duties, Imposts, and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States." The omission of any reference to "taxes" or "direct taxes" in the uniformity clause was extensively commented upon by the Supreme Court as early as 1796 in \textit{Hylton v. United States}, 3 U.S. (3 Dall.) 171, 173 (1796) ("If there are any other species of taxes that are not direct, and not included within the words duties, imposts or excises, they may be laid by the rule of uniformity or not; as congress shall think proper and reasonable.").

34. 157 U.S. 429, vacated on rehearing, 158 U.S. 601 (1895).

35. \textit{Id.} at 557.

36. \textit{See, e.g.,}\ Knowlton v. Moore, 178 U.S. 41 (1900); Pollock v. Farmers' Loan and Trust Co., 157 U.S. 429, vacated on rehearing, 158 U.S. 601 (1895); Springer v. United States, 102 U.S. 586 (1880); \textit{Veazie Bank v. Fenno}, 75 U.S. (8 Wall.) 533 (1869); Pacific Ins. Co. v. \textit{Soule}, 74 U.S. (7 Wall.) 433 (1868); \textit{Hylton v. United States}, 3 U.S. (3 Dall.) 171 (1796). In each case the Court was called upon to decide whether a particular tax was a direct or an indirect tax. In \textit{Hylton}, after ruling that a tax on carriages was an indirect tax because it was levied on personal property, Justice Chase offered his opinion that the Constitution contemplated only two types of direct taxes: Capitation or poll taxes (which impose an identical fee on all individuals subject to the tax) and taxes on land. 3 U.S. at 175. Accordingly, \textit{Soule} and \textit{Springer} held that income taxes were not direct taxes and were not, therefore, subject to a rule of apportionment. Similarly, taxes imposed by Congress on notes issued by state banks in \textit{Veazie Bank} were found to be indirect. In 1895, however, the Supreme Court
The ratification of the sixteenth amendment in 1913 added a new element to the debate. The amendment provided that the rule of apportionment no longer applied to income taxes; therefore, the distinction between direct and indirect taxes insofar as income taxes were concerned became less important. Immediately, the issue arose of whether the rule of uniformity still applied to income taxes. Although the amendment had made no mention of uniformity, the Supreme Court in Brushaber v. Union Pacific Railroad held that the rule of uniformity still applied to income taxes.

When the federal rule of uniformity applies, it does not require pursuit of "a baseless dream" of "[p]erfect uniformity and perfect equality of taxation." The rule does not, for instance, render progressive income tax schedules void. Instead, the rule refers to geographical uniformity and mandates that a tax "operate generally throughout the United States." In the case of the Kemp-Garcia bill, the rule would require that enterprise zone status and the incentives which follow be available to every qualified community in the United States. Undoubtedly some states would benefit more

---

37. U.S. Const. amend. XVI.
38. 240 U.S. 1 (1916).
39. Id. at 24. The plaintiff in Brushaber was a stockholder who challenged a corporate income tax imposed by Congress in the wake of the sixteenth amendment. He contended, in part, that the tax violated the due process, equal protection, and uniformity clauses of the Constitution. The Court disagreed, and affirmed defendant's motion to dismiss. The Court cited Knowlton as authority for a correct interpretation of the uniformity clause. Id.
40. Head Money Cases, 112 U.S. 580, 595 (1884) (duty imposed on shipowners of 50 cents per immigrant transported to the United States valid under the uniformity clause even though ships carrying citizens or cargo were not subject to this tax).
42. Knowlton v. Moore, 178 U.S. at 96. Knowlton contains a complete discussion of the meaning of the uniformity rule and credits Madison with the definition that taxes must "operate generally" throughout the United States. Id. at 83-106.
than others from the legislation, but that fact alone would be insufficient to constitute a violation of the uniformity rule. The Constitution does not require the distribution of uniform benefits nationwide; it requires the uniform application of federal tax laws.

Uniformity clauses in state constitutions vary, and some states omit uniformity requirements altogether. In each state, the property tax reduction required of a local government as a prerequisite for Kemp-Garcia benefits would have to comply with the state's uniformity rule. An early view held that a uniformity clause in a state constitution meant that all property within the state must be taxed if any is to be taxed, but modern support for this position is lacking. The more reasonable approach is to apply the federal standard and require only that all tax laws apply generally throughout the state, subject to any exemptions which the legislature may deem necessary. Most courts have taken this approach. As Justice Cardozo concluded in *Williams v. Mayor and City Council* in upholding a special tax exemption in the face of a

---

43. See generally Rhode Island Chapter, Associated Gen. Contractors of America, Inc. v. Kreps, 450 F. Supp. 338 (D.R.I. 1978), which focused on Congress' spending power in upholding an affirmative action law: "Nor is there any doubt that Congress may pin-point spending in various localities of intense unemployment and underemployment or that it may choose to concentrate on urban poverty or rural poverty or that it may attack certain sources of poverty without challenging others." *Id.* at 349. Similarly, Congress must be free to provide tax incentives to businesses located in the poorest neighborhoods so long as those incentives do not violate the uniformity clause by being totally or partially unavailable to any qualified community. See note 46 infra and accompanying text.

44. See note 31 supra.

45. Louisville & Nashville R.R. v. Palmes, 109 U.S. 244 (1883); Railroad Cos. v. Gaines, 97 U.S. 697 (1878); City of Savannah v. Weed, 84 Ga. 683, 11 S.E. 235 (1890); Redmond v. Town of Tarboro, 106 N.C. 122, 10 S.E. 845 (1890). Language in each of these cases would support a challenge to an exemption under a state uniformity clause. In *Gaines*, for example, the Court held that after Tennessee added a uniformity clause to its constitution, the legislature could no longer grant tax exemptions to individual railroads. 97 U.S. at 709. No case has been found, however, which expressly holds that a uniformity clause renders a legislature totally powerless to exempt.

46. See, e.g., Township of Pine Grove v. Talcott, 86 U.S. (19 Wall.) 666, 675 (1873) (Michigan's uniformity clause interpreted to require: "All kinds of property must be taxed uniformly, or be entirely exempt. The uniformity must be coextensive with the territory to which the tax applies. If a State tax, it must be uniform all over the State. If a county or city tax, it must be uniform throughout such county or city." *Id.*); Wheeler v. Weightman, 96 Kan. 50, 149 P. 977 (1915).

47. 289 U.S. 36 (1933).
state uniformity clause, "the correcting statute may be as narrow as the mischief."\textsuperscript{48}

\section*{B. Compliance with the Equal Protection Clause}

The equal protection clause of the fourteenth amendment\textsuperscript{49} would be of little use in challenging the Kemp-Garcia bill. As noted by Chief Justice Taft in \textit{Truax v. Corrigan},\textsuperscript{50} the fourteenth amendment's equal protection clause applies exclusively to state action.\textsuperscript{51} Congressional action in providing federal tax incentives for businesses within enterprise zones could not, therefore, be challenged under this clause.\textsuperscript{52}

State action in providing real property tax reductions within enterprise zones, however, would be subject to the requirements of both federal and state equal protection clauses. The general rule is that state legislatures have broad discretion in determining what is taxable and what is exempt.\textsuperscript{53} Yet under the fourteenth amend-

\footnotesize{\textsuperscript{48} \textit{Id.} at 46. \textit{Williams} involved a Maryland statute which provided a financially crippled railroad with a two year exemption from state, county, and city taxes. The City of Baltimore challenged the exemption under the uniformity clause in the state constitution. In upholding the statute, the Court stressed that the uniformity rule "does not forbid the creation of reasonable exemptions in furtherance of the public good." \textit{Id.} at 41. In relation to the Kemp-Garcia bill, \textit{Williams} provides strong support for the validity of local real property tax reductions despite state uniformity clauses. What Justice Cardozo wrote in support of the Maryland statute could also be said of enterprise zone legislation: "Furtherance of the public good is written over the face of this statute from beginning to end as its animating motive." \textit{Id}. \\

\textsuperscript{49} U.S. Constr. amend. XIV, § 1. \\

\textsuperscript{50} 257 U.S. 312 (1921). \\

\textsuperscript{51} \textit{Id.} at 340. In \textit{Truax}, the Chief Justice compared the histories of the due process and equal protection clauses. He traced the due process clause from the Magna Carta through some of the early state constitutions to the fifth and fourteenth amendments of the United States Constitution. The equal protection clause, on the other hand, did not appear until the fourteenth amendment. \textit{Id.} at 332. The defendants in \textit{Truax} argued that if the Court found a state statute which barred injunctions in most labor disputes unconstitutional under the equal protection clause, it must also find a similarly worded section in the Clayton Act unconstitutional. The Court disagreed, responding that the equal protection clause "does not apply to Congressional action but only to state action." \textit{Id.} at 340. \\

\textsuperscript{52} Congressional action could be challenged under the fifth amendment's due process clause, but the Supreme Court has indicated that the clause cannot restrict reasonable exercise of Congress' taxing power. U.S. v. Kahriger, 345 U.S. 22, 33-34 (1953); Steward Machine Co. v. Davis, 301 U.S. 548, 583-85 (1937); Brushaber v. Union Pac. R.R., 240 U.S. at 24-26. \\

\textsuperscript{53} The Del. R.R. Tax, 85 U.S. (18 Wall.) 206 (1873), exemplifies this firmly settled general rule. Delaware first exempted and then taxed the capital stock of a railroad which operated in the state. In upholding the tax the Court wrote, "[i]t has . . . been repeatedly held by this court that the legislature of a State may exempt particular parcels of property or the
ment's equal protection clause, "[t]ax exemptions are subject to the limitation that they and the classification upon which they are based be reasonable, not arbitrary, and apply to all persons similarly situated."" In Wheeling Steel Corp. v. Glander, the "rational basis" limitation was employed to invalidate an Ohio statute which imposed an ad valorem tax on foreign corporations while exempting domestic corporations. The Court held that a state may not structure a tax schedule solely on the basis of residence in order to tax the nonresident at a higher rate.

In contrast to Wheeling Steel, Allied Stores v. Bowers indicates that a state may grant exemptions primarily on the basis of residence when public policy factors are also present. The Court

property of particular persons or corporations from taxation, either for a specific period or perpetually, or may limit the amount or rate of taxation, to which such property shall be subjected." Id. at 225. Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973), provides a more recent statement of the rule. Plaintiff corporation argued that a provision in the Illinois Constitution which imposed a personal property tax on corporations and not on individuals, ILL. CONST. art. IX, § 5, was unconstitutional under the equal protection clause. The Court upheld the tax, stating, "[w]hen it comes to taxes on corporations and taxes on individuals, great leeway is permissible so far as equal protection is concerned." Id. at 360.

54. United States v. Department of Revenue, 202 F. Supp. 757, 759 (N.D. Ill.); aff'd per curiam, 371 U.S. 21 (1962) (state retailers' occupation tax valid under the limitation even though it exempted retailers who sold to charities, schools, and churches, but not retailers who sold to the federal government). The Supreme Court in recent years has given no indication that it would abandon this "rational basis" test in favor of a "strict scrutiny" test in an analysis of a tax exemption statute. The Court has continually subjected state legislation in the nature of "local economic regulation" to a rational basis test. Friedman v. Rogers, 440 U.S. 1, 17 (1979); Massachusetts Bd. of Retirement v. Murgia, 427 U.S. 307, 312 (1976); New Orleans v. Dukes, 427 U.S. 297, 303 (1976); Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 360 (1973). In fact, the current Court has indicated that the rational basis test may apply even when the local regulation involves a government agency accused of discriminatory employment practices. In New York Transit Auth. v. Beazer, 440 U.S. 568 (1979), plaintiffs were participants in methadone treatment programs who challenged a Transit Authority rule prohibiting the use of all narcotics by Transit Authority employees. Plaintiffs argued that the rule unfairly discriminated against methadone users, especially the blacks and Hispanics who constituted approximately two-thirds of those enrolled in public methadone treatment programs. Id. at 585. The Court upheld the rule and the Transit Authority's dismissal of employees participating in the programs. Id. at 594. The Court viewed the rule as a "policy decision" which, however unwise, was rationally based on a desire by the Transit Authority to maintain a safe system of public transportation. Id. at 571, 594.

55. 337 U.S. 562 (1949).
56. Id. at 572.
57. Id.
59. Id. at 528.
in *Allied Stores* admitted that it did not know for certain what the Ohio Legislature intended when it exempted foreign corporations from a particular *ad valorem* tax, but because "it is obvious that it may reasonably have been the purpose" of the legislature to stimulate the state's economy, the tax was valid under the equal protection clause.\(^6\) The actions of a state or local legislature pursuant to a Kemp-Garcia statute should certainly transcend the confines of *Wheeling Steel* and come within the broader reaches of *Allied Stores*.

One case decided by the Third Circuit dealt directly with the issue of whether industrial tax incentives available only to certain businesses deny other taxpayers equal protection of the laws. In *Virgo Corp. v. Paiewonsky*,\(^6\) the court held that the Virgin Islands' industrial incentive program\(^6\) did not violate the territory's equal protection clause\(^6\) merely because the governor had denied plaintiff's application for incentives while approving the applications of plaintiff's competitors.\(^6\) The Third Circuit dismissed plaintiff's allegation that the governor's decisions were politically motivated\(^6\) and focused instead on the statute's validity under the equal protection clause. Because the goal of strengthening the Virgin Islands' economy constituted a rational basis for the legislation, the statute withstood constitutional challenge.\(^6\)

There is nothing unreasonable or palpably arbitrary about the proposed Kemp-Garcia legislation which would result in its invalidation under an equal protection clause. Certainly some communities would benefit greatly from the legislation while others faced

---

60. *Id.* at 528-29. The Court distinguished *Wheeling Steel* on the ground that it involved taxes on foreign corporations levied in response to sister state taxes on Ohio corporations. The Court concluded that such taxes have no purpose other than to discriminate. *Id.* at 529-30. Justice Brennan in a concurring opinion offered a cogent analysis of the distinction between the two cases. He noted that under the federal system, a tax which discriminates against nonresidents as in *Wheeling Steel* is far more likely to violate the equal protection clause as "state action disruptive of the federal pattern" than a tax which discriminates in favor of nonresidents as in the case before the Court. *Id.* at 533 (Brennan, J. concurring).


62. *See note* 130-38 *infra* and accompanying text for an analysis of the Virgin Islands' program.


64. *Virgo Corp. v. Paiewonsky*, 384 F.2d at 586.

65. *Id.* at 585-86.

66. *Id.* at 586.
with economic hardship would not even qualify for assistance. Courts have indicated, however, that neither the equal protection nor uniformity clauses will be of much assistance in challenging the broad powers of a legislature to tax, exempt, and provide incentives.

III. Forerunners to the Legislation: Previous Tax Incentives Designed to Stimulate Private Enterprise

A. Early Incentives

Tax incentives have been used in the United States to accelerate economic growth since the early days of the Republic. In the nineteenth century, legislatures commonly exempted railroads from taxation in order to ensure the speedy construction of rail lines within their states. Banks, representing another important factor in the economic growth of a state, were also frequent beneficiaries of the exemptions and abatements. The terms of the various exemptions differed, reflecting the specific designs of the legislatures drafting them. Some exemptions were intended to assist new companies in their infancy and were therefore valid for only a limited number of years. Some exemptions were total; others

---

67. Enterprise zone status would not be available, for example, to an area with a population of less than 4,000 persons (unless the area were also an Indian reservation). H.R. 7563, tit. I, sec. 101(a), subch. C, § 7871(c)(1)(C). Even a larger area suddenly hit with high unemployment would not qualify until two years had passed and complete unemployment figures could be compiled. Id. § 7871(c)(1)(2). See notes 154-86 infra and accompanying text for a discussion of how zones would be designated under the Kemp-Garcia bill.

68. The Supreme Court in Wilmington R.R. v. Reid, 80 U.S. (13 Wall.) 264 (1871), traced the use of tax incentives in North Carolina to a 1790 exemption incorporated in the charter of the Dismal Swamp Canal Company. Id. at 265.

69. Often legislatures were silent as to their reasons for exempting railroads. In certain instances, however, states manifested a desire to become or remain competitive with other states' systems of transportation. Florida in 1855, for example, passed "An Act to Provide for and Encourage a Liberal System of Internal Improvements in this State" which stated, in part, that "the capital stock of any railroad company accepting the provisions of this act shall be forever exempt from taxation. . . ." 1855 Fla. Laws ch. 610, § 18, reprinted in part in Atlantic and Gulf R.R. v. Allen, 15 Fla. 637, 659 (1876).

70. See, e.g., Bank of Commerce v. Tennessee, 161 U.S. 134, 135, modified, 163 U.S. 416 (1896) (bank agreed to pay annual tax of one half percent on each share of capital stock in lieu of all other taxes); Jefferson Branch Bank v. Skelly, 66 U.S. (1 Black) 436, 445 (1861) (bank permitted to pay six percent on its annual dividends in lieu of all other taxes).

71. See, e.g., Wright v. Georgia R.R. and Banking Co., 216 U.S. 420, 422 (1910) (railroad stock exempt for seven years after completion of the railroad, but then subject to a tax on net proceeds); Mobile and O. R.R. v. Tennessee, 153 U.S. 486, 488 (1894) (railroad's fixed
were partial. Usually exemptions were written into the charters of specific companies; occasionally they were enacted into statutes and applied generally to all qualified businesses throughout the state.

The most troublesome variety of the early tax incentives was the perpetual exemption. Businesses lobbied for these exemptions because, as the Supreme Court once explained, "[a] more important or more comprehensive privilege than a perpetual immunity from taxation can scarcely be imagined." State legislatures were not adverse to granting perpetual exemptions, especially during periods of growth and industrialization such as the mid-nineteenth century. The problem arose years later when subsequent legislatures reconsidered the exemptions and attempted to impose new
taxes. Many businesses confronted with this unexpected tax liability successfully argued that the new taxes impaired the obligation of a contract they had with the state. The court would uphold the new taxes, however, if the exemption had never been more than a gratuity conferred by the legislature. This distinction between binding and non-binding perpetual exemptions may prove to be an important one under the Kemp-Garcia bill, which calls for the enactment of permanent real property tax reductions in areas designated as enterprise zones.

B. Development of Targeted Incentives

Toward the end of the nineteenth century, state and local legislatures began granting fewer charter exemptions for the benefit of individual companies and more statutory exemptions for the benefit of all those qualified. When New York imposed a capital stock tax on corporations in 1880, for example, it expressly exempted banks, insurance companies, and “manufacturing corporations carrying on manufacture within this State.” The reason for exempting manufacturers, according to one New York court, was “the desire on the part of the State to bring within its borders the advantages which attend the maintaining of large manufacturing establishments and the employment of many men therein.” Pennsylvania, mindful of the incentives available in New York,

78. Id.; Wright v. Georgia R.R. and Banking, 216 U.S. 420, 422 (1910) (holding that a new tax imposed by the Georgia Legislature applied only to property acquired by a railroad after its charter exemption; the state conceded that “the charter constitutes a contract which may not be impaired by subsequent legislation.” Id.); Jefferson Branch Bank v. Skelly, 66 U.S. (1 Black) 436 (1861).

79. West Wis. Ry. v. Board of Supervisors, 93 U.S. 595 (1876); Tucker v. Ferguson, 89 U.S. (22 Wall.) 527 (1874). In each case, the Court held that there had never been a contract between the legislature and the exempted company which would prevent the withdrawal of the exemption. As the Court pointed out in West Wisconsin Railway, “[t]he State asked for no promise from the company, and the company gave none.” 93 U.S. at 598. A later decision emphasized that in neither case was the exemption expressed in the company’s charter. Asylum v. New Orleans, 105 U.S. 362, 368 (1881) (perpetual exemption written in the charter of a charitable institution upheld).


82. People ex rel. Blackington Co. v. Roberts, 4 A.D. 388, 390 (3d Dep’t 1896), aff’d, 151 N.Y. 652, 46 N.E. 1150 (1897) (company which manufactured textiles in Massachusetts and sold them in New York not entitled to the exemption).
provided manufacturers with a similar exemption from its capital stock tax in 1885.\textsuperscript{88} Exemptions such as these, aimed at specific industries and regions, were the ideological predecessors of the enterprise zone.

The problem which arose with exemptions written for particular industries was the continuing need to define the statute to decide which companies were exempt. An ordinance in Louisville, Kentucky, for example, exempted “manufacturing establishments” from all city taxes for a period of five years “in order to induce the location of more manufacturing establishments within the city. . . .”\textsuperscript{84} A Louisville company which made men’s suits to the specifications of local dealers requested the exemption. The Court of Appeals of Kentucky, after consulting dictionaries, statutes and cases, held that the business was not entitled to the exemption, primarily because a line had to be drawn somewhere or every business in the city would be exempt.\textsuperscript{85} Other courts over the years have ruled that utilities,\textsuperscript{86} scrap metal recyclers,\textsuperscript{87} and makers of popcorn for theaters\textsuperscript{88} were not manufacturers for the purposes of an exemption. The Kemp-Garcia bill avoids this problem of defining types of industries by providing tax incentives to all qualified businesses located in an enterprise zone.\textsuperscript{89}

\begin{itemize}
  \item 83. Further Supplement of June 30, 1885, no. 162, § 20, 1885 Pa. Laws 193 (amending 1879 Pa. Laws 112) (amended 1889). In Commonwealth v. Northern Elec. Light & Power Co., 145 Pa. 105, 22 A. 839 (1891), the court stated, When the act of 1885 was passed, laws had been made in adjoining states which gave encouragement to the establishment of factories by exempting them from certain forms of taxation. The mischief to be remedied was the danger that such legislation might lead to the removal of capital and labor from this state to others, to the detriment of the business and prosperity of our own. Id. at 120, 22 A. at 841.
  \item 84. LOUISVILLE, KY., ORDINANCE, reprinted in part in Standard Tailoring Co. v. Louisville, 152 Ky. 504, 505, 153 S.W. 764, 765 (1913).
  \item 85. 152 Ky. at 509-10, 153 S.W. at 767. The court feared that if appellants “tailors to the trade” were granted an exemption, then all tailors and dressmakers would demand an exemption, followed by all shoemakers, all carpenters, etc. Id. Whether or not the case was correctly decided, it does illustrate the kind of problem this type of statute creates.
  \item 89. The Kemp-Garcia bill does not entirely avoid the problem, though. By offering incentives only to “qualified” businesses in a zone, the bill may give rise to litigation on the
Legislatures continued to use targeted tax incentives, when necessary, in the early part of the twentieth century. The South was especially active during the first three decades in its attempts to revive specific areas of its slumping economy. Arkansas, for instance, amended its constitution in 1926 to provide a seven year exemption for all capital invested in cotton mills.\footnote{Ark. Const. amend. 12, § 1. The amendment, still in effect, allows an exemption “for a period of seven years from the date of the location of said textile mill.” Id. The amendment was upheld under the equal protection clause in Wilson v. Monticello Cotton Mills Co., 180 Ark. 1090, 24 S.W.2d 324 (1930) (cotton mill entitled to refund of taxes unlawfully collected by county).} Alabama, hoping to encourage “the building, extending and operating of factories,” enacted a statute in 1927 which exempted factories from all county and municipal taxes for a period of five years;\footnote{Act of Sept. 6, 1927, no. 559, § 1, 1927 Ala. Acts 641. The act survived a challenge on state constitutional grounds that it conflicted with a special school tax amendment, Ala. Const. amend. 19, §§ 1, 2, in Pullman Car & Mfg. Corp. v. Hamilton, 229 Ala. 74, 155 So. 616 (1934), aff’d on rehearing, 230 Ala. 688, 163 So. 329 (1935).} Georgia had amended its constitution three years earlier to include a similar provision.\footnote{Ga. Const. of 1877, art. 7, § 2, para. 2 (1924) (repealed 1976).} South Carolina in 1925 enacted a statute which, like the Kemp-Garcia plan, offered tax incentives only to those businesses located in certain areas.\footnote{Act of March 5, 1925, no. 468, 1925 S.C. Acts 891. Section 1 of the act provided: “Any and all manufactories desiring to locate in [one of eleven specified counties] with a capital of not less than one hundred thousand ($100,000.00) dollars shall be exempt from all county taxes, except for school purposes, for the five (5) years from the time of their establishment.” Id. An interesting problem arose when a power company located on the “taxable” side of a river decided to build its new plant on the “exempt” side of the river. The court in Duke Power Co. v. Bell, 166 S.C. 299, 152 S.E. 865 (1930), permitted the exemption.} The use of targeted incentives in the early part of the century extended beyond those exemptions intended to lure manufacturers to particular states or cities. When New York State, and especially New York City, experienced a serious housing shortage following the end of the first world war, the state legislature responded by passing a series of laws intended to encourage new construction.\footnote{Acts of Sept. 27, 1920, cha. 942-953, 1920 N.Y. Laws 2477 (amended 1921). For a thorough account of the housing shortage and state and local efforts to overcome it, see Special Committee on Tax Policies, How Tax Exemption Broke the Housing Deadlock in New York City (May 1960) [hereinafter cited as Special Committee on Tax Policies].} The principal statute provided that local governments could ex-
empt all new buildings “planned for dwelling purposes,” except hotels, from local taxation.95 New York City agreed to offer the exemptions for a period of ten years,96 and several other communities in the state followed suit.97 The statutes withstood a court challenge98 and successfully alleviated the housing shortage.99

Several states found new cause to pass targeted tax incentive laws during the Depression. In 1936, when the Mississippi legislature chose to exempt for five years many new factories from all ad valorem taxes, its express purpose was to provide relief from “an acute, economic emergency.”100 Massachusetts enacted a statute that same year which imposed, in lieu of all local taxes, lower state taxes on machinery used by manufacturers.101 Also in 1936, Louisiana amended its constitution to provide a State Board of Com-

96. New York, N.Y., Ordinance 112 (Feb. 15, 1921), reprinted in Hermitage Co. v. Goldfogle, 204 A.D. 710, 719, 199 N.Y.S. 382 (1st Dep't 1923). The ordinance limited the exemptions to approximately $1000 per room, depending on the type of dwelling. Because the ordinance also put a time constraint on the exemptions by providing a fixed termination date of January 1, 1932, the incentives most benefited those builders who acted quickly.
97. See SPECIAL COMMITTEE ON TAX POLICIES, supra note 94, at 3-32.
98. Hermitage Co. v. Goldfogle, 204 A.D. 710, 199 N.Y.S. 382 (1st Dep't 1923). The court ruled that neither the state statute nor the city ordinance was unconstitutional. Using language which could apply as well to enterprise zone legislation, the court wrote that the exemption “was a bargain between the State and the owner of vacant property, by which no one was the loser. The State gained additional housing facilities for its citizens, the owner gained an exemption from local taxes, the locality gained improved real estate subject to taxation when the period of exemption should expire.” Id. at 727.
99. See SPECIAL COMMITTEE ON TAX POLICIES, supra note 94, at 1-9 to -10. This study concluded that the incentives produced a “building boom” which began in 1921 and intensified over the next four years. Id. at 1-9. For an analysis of tax incentives currently available to encourage new housing in New York City, see Griffith, Revitalization of Inner City Housing Through Property Tax Exemption and Abatement: New York City’s J-51 to the Rescue, 18 URB. L. ANN. 153 (1980).
100. Balance Agriculture with Industry Act, ch. 1, Preamble, § 19, 1936 Miss. Laws 1st Extr. Sess. 5 (amended 1936). The legislature noted that the emergency had “decreased Mississippi’s industrial enterprises so that many of her citizens are on relief and are leaving the state. . . .” Id. Preamble. Therefore, every new factory “of public utility” could take advantage of the exemption. Id. § 19. Even the word “new” was to be construed liberally. When a shirt manufacturing company began operating at an idle factory site, for example, the Mississippi Supreme Court ruled that the company was entitled to the exemption. Meador v. Mac-Smith Garment Co., 188 Miss. 98, 191 So. 129 (1939).
merce and Industry with the authority to exempt new or expanding industries from all state taxes for a period of up to ten years.\footnote{102}

Since the Depression, most of the nation has participated in an era of growth which has lessened the need for incentives aimed at specific industries and regions. Two important incentive programs were developed in Puerto Rico and the Virgin Islands after the Second World War.\footnote{103} In the 1950's and 60's, some states supplemented their urban renewal programs with tax incentives in order to enlist the aid of private enterprise;\footnote{104} however, the number of specific tax incentives granted by a legislature to bring specific industries into an area have levelled off in recent years.\footnote{105} If there is a trend to be found in the history of these incentives, it is simply that they appear less often when times are good than when times are bad. For those who would agree that times have never been worse for many of the nation's cities, the appearance of the Kemp-Garcia bill should come as no surprise.

\footnote{102}{\textsc{La. Const.} of 1921, art. X, § 4 (1936) (current version at \textsc{La. Const.}, art. 7, § 21(F)). The amendment gave the Board wide discretion in making contracts in the best interests of the state. In one instance, a new industry which was denied an exemption brought suit seeking to compel the Board to grant the exemption. The Louisiana Supreme Court held that absent an abuse of discretion, the Board was free to grant exemptions as it saw fit. State ex rel. Kohler's Snowite Laundry & Cleaners, Inc. v. State Bd. of Commerce and Indus., 205 La. 622, 17 So. 2d 899 (1944).}

\footnote{103}{See notes 116-38 infra and accompanying text.}

\footnote{104}{See, e.g., 2 Mo. Rev. Stat. § 353.110 (1959) (privately held urban redevelopment corporations exempt from general \textit{ad valorem} taxes for ten years). The Missouri statute was challenged and held constitutional in Annbar Assocs. v. West Side Redevel. Corp., 397 S.W.2d 635 (1965), \textit{appeal dismissed for want of a federal question}, 385 U.S. 5 (1966); Ohio Rev. Code Ann. § 725.02 (Page) (1976) (all improvements to real property in an urban renewal area are exempt from real property taxes so long as urban renewal bonds for the area are outstanding).}

\footnote{105}{Two federal programs offer a limited number of incentives in the form of grants and loans to qualified regions and businesses. The Small Business Administration is authorized to make loans of up to $100,000 to certain "small business concerns located in urban or rural areas with high proportions of unemployed or low-income individuals, or owned by low-income individuals. . . ." 15 U.S.C. § 636(i)(1) (Supp. III 1979). A Housing and Urban Development program provides Urban Development Action Grants ("UDAG grants") to "severely distressed cities and urban counties" which have formulated detailed renewal plans. 42 U.S.C. § 5318 (Supp. III 1979). Proponents of enterprise zones argue that the SBA and HUD programs are overly bureaucratic and generally unresponsive to high-risk projects. See, e.g., S. BUTLER, supra note 5, at 10-12.}
C. The Kennedy Proposal of 1967

When Senator Robert Kennedy introduced a bill to create the Urban Employment Opportunities Development Act of 1967,\(^{106}\) he stated, "the specific purpose of the bill is to stimulate investment—the creation of new jobs and income—in poverty areas."\(^ {107}\) Kennedy reminded the Senate that his tax incentive proposals would require "no great new outflows of Government spending" but would encourage the private sector to bring jobs to urban poverty areas.\(^ {108}\) The Kennedy bill, like the Kemp-Garcia bill, proposed offering tax incentives for a period of ten years to qualified businesses located in economically depressed areas.\(^ {109}\) Kennedy’s definition of a qualified business, however, was a narrow one. For a business to obtain a "Certificate of Eligibility" it had to be "an industrial or commercial enterprise" employing at least fifty people on a full time basis.\(^ {110}\) Retail stores were excluded from the program,\(^ {111}\) as were businesses relocating from other areas.\(^ {112}\) Addi-


\(^{107}\) 113 Cong. Rec. 18443 (1967) (remarks of Sen. Robert Kennedy). There is little difference between the language used by the supporters of the Kennedy bill in 1967 and that used by the supporters of the Kemp-Garcia bill today. For instance, Senator Kennedy stated, "After extensive consultation with representatives of business, labor, government, the academic community, and the urban poor themselves, our expectation is that these incentives will give our private enterprise system—the most ingenious and productive the world has ever known—the help it needs to effectively attack the difficult and resistant problems of urban unemployment." 113 Cong. Rec. 18443. By comparison, Representative Garcia recently stated, "[t]he key to area-wide redevelopment is opportunity development—or, more precisely, the reestablishment of opportunity producing incentives in areas where they no longer exist. . . .” 126 Cong. Rec. E3880 (daily ed. Aug. 19, 1980).

\(^{108}\) 113 Cong. Rec. 18443.

\(^{109}\) S. 2088, 90th Cong., 1st Sess., tita. I-II. Specifically, the Kennedy bill would have provided the following incentives in urban poverty areas: a seven percent tax credit on business expenditures for real property, a 10% credit on business expenditures for personal property, a one-third useful life reduction on most property, an extension of net operation loss carryovers from five to ten years, and a deduction of 25% of the salaries paid to certain workers hired under the program. Id. tit. II.

\(^{110}\) Id. tit. I, § 101(a)(3)(B). Under an exception applicable only to Indian reservations and qualified urban areas with populations of less than 50,000 persons, businesses could employ twenty-five full-time employees and still be eligible for the incentives. Both the rule and exception, however, required that two-thirds of all employees be either residents of the poverty area for at least six months or unemployed before their present jobs. Id.

\(^{111}\) Id. § 3(5)(E).

\(^{112}\) Id. § 2. This provision, although it discourages the creation of some jobs in poor neighborhoods, is worth noting. One argument against the creation of enterprise zones is that they will merely "rob Peter to pay Paul." See S. Butler, supra note 5, at 33. A provi-
tionally, few areas outside the impoverished neighborhoods of large cities were eligible to receive the incentives. Although the bill received bilateral support when it was introduced, it never emerged from the Senate Finance Committee.

D. Industrial Incentive Programs in Puerto Rico and the Virgin Islands

When Senator Kennedy introduced his bill in 1967, he noted the two decades of success achieved by an industrial incentive program in Puerto Rico. Puerto Rico passed its first Industrial Tax Exemption Act in 1948. As part of the government's "Operation Bootstrap" program, the act was designed to encourage industrial growth in Puerto Rico at a time when agriculture was the mainstay of the economy.

Under the present Puerto Rican program, the governor grants
exemptions to businesses on an individual basis.\footnote{121} Applicants are screened carefully to make certain that each exemption will serve the best interests of the commonwealth.\footnote{122} Only certain types of businesses may apply, but among those eligible are industrial units,\footnote{123} tourist hotels,\footnote{124} and designated services.\footnote{125} Once the governor approves a designation, the business is entitled to a series of partial exemptions which decrease in value over the years.\footnote{126} The exact number of years that a business will enjoy its exemptions depends on its location. Puerto Rico is divided into four categories

\footnote{121}{Act of 1978, § 255a(c) (Supp. 1979).}
\footnote{122}{Id. § 255h(a). The section provides that the governor may refuse to grant an exemption to any business, if in his judgment the exemption would not "serve the best social and economic interests of the People of Puerto Rico." Id. In Everlasting Dev. Corp. v. Descartes, 192 F.2d 1 (1st Cir. 1951), plaintiff building corporation sought declaratory relief after the tax exemption council and the governor had rejected its application. The 1948 Act, like the current law, required the council and the governor to consider many factors when ruling on an application. Act of 1948, § 2. The court denied relief, refusing to interfere with "a judgment . . . political in nature rather than judicial." 192 F.2d at 6.}
\footnote{123}{Act of 1978, §§ 255a(d)(1)-(5) (Supp. 1979).}
\footnote{124}{Id. § 255a(d)(7). A tourist hotel is defined as a hotel which caters to the tourist trade by offering beaches, swimming pools, court games, etc. Id. § 255a(f)(1). To be distinguished are commercial hotels, defined as all other hotels under the 1963 Act. Act of 1963, § 252a(f)(2). A comparison of the two acts reveals how incentives change to meet the needs of the times. Under the 1963 Act, all tourist hotels, commercial hotels, and guest houses could apply for exemptions. Id. §§ 252a(d)(5)-252a(d)(6). Under the current law, only tourist hotels which were closed or under construction on January 1, 1978 may apply. Act of 1978, § 255a(d)(7) (Supp. 1979).}
\footnote{125}{Act of 1978, § 255a(d)(9) (Supp. 1979). Among the services which may apply for exemptions are banks, consulting firms, mail order houses, computer service centers, and medical laboratories. Id. § 255a(o). Because the prior acts emphasized industrial development, most services could not apply for exemptions until the enactment of the current statute. The legislature wrote the new law to "generate a substantial number of well-remunerated jobs in addition to those created in the manufacturing phase." Industrial Incentive Act of 1978, No. 26, 1978 P.R. Laws 55, 57.}
\footnote{126}{The 1978 Act is the first act which emphasizes partial, rather than total, exemptions for eligible businesses. Act of 1978, § 255b (Supp. 1979); cf. Act of 1963, § 250. The primary incentives available to most businesses are partial exemptions from industrial development income, personal property, and real property taxes, and total exemptions from license fees, local excise taxes, and other municipal taxes. Act of 1978, §§ 255b(a)-(c) (Supp. 1979). When the partial exemptions apply, most businesses are entitled to a 90% exemption for the first five years, a 75% exemption for the next five years, a 65% exemption for the next five years (if the exemption is for more than ten years), a 55% exemption for the next five years, and a 50% exemption for the final five years. Id. §§ 255b(a)-(b). The rule is different for service units. They are entitled to partial exemptions from the same taxes, but at the lesser rate of 50% for the entire period of exemption. Id. § 225b(o). Service units are entitled to the same total exemptions as other businesses. Id.}
of zones, with exemptions available for ten years in Zone I areas and twenty-five years in Zone IV areas.\textsuperscript{127} Certain industries may find the 1978 Act less attractive than its predecessors, but the act was designed to achieve "a public policy for development which is totally integrated to the social, economic, ecological and fiscal needs of our Government."\textsuperscript{128} Nonetheless, the results of thirty years of industrial incentive laws in Puerto Rico have been impressive.\textsuperscript{129}

The United States Virgin Islands enacted its first Industrial Incentive Program in 1957.\textsuperscript{130} The current law\textsuperscript{131} provides that individual businesses must apply to the Industrial Development Commission to receive the benefits of the program.\textsuperscript{132} To be eligible, a business must make an investment of at least $50,000 exclusive of inventory, employ at least ten Virgin Islands residents on a full time basis, and agree to purchase all reasonably priced goods and services from native firms.\textsuperscript{133} Like the Puerto Rican program, the statute allows its Commission to exercise broad discretion in deciding which applications to approve.\textsuperscript{134} When an application is ap-

\textsuperscript{127} \textit{Id.} § 255b(d)(1). Exemptions are available in a Zone I area, one of "high industrial development," for ten years; a Zone II area, one of "intermediate industrial development," for 15 years; a Zone III area, one of "low industrial development," for 20 years; and a Zone IV area, the islands of Vieques or Culebra, for 25 years. \textit{Id.}

\textsuperscript{128} 1978 P.R. Laws 26.

\textsuperscript{129} According to \textit{Arthur Andersen}, supra note 118, industrialization proceeded at a rapid pace after the Act of 1948, with the Gross national product increasing fourfold in 15 years. \textit{Id.} at 111-12.

\textsuperscript{130} Industrial Incentive Program, No. 224, 1957 V.I. Laws 146 (superseded 1961). The statute was held constitutional in \textit{Port Constr. Co. v. Virgin Islands}, 359 F.2d 663 (3d Cir. 1966) (no denial of equal protection because the incentives were available only to businesses organized under Virgin Islands law).


\textsuperscript{132} V.I. CODE ANN. tit. 29, § 705(a) (Supp. 1979).

\textsuperscript{133} \textit{Id.} § 708. Businesses are also required to incorporate under Virgin Islands or United States law, meet the requirements of I.R.C. § 934 (relating to income tax exemptions for certain Virgin Islands residents and corporations), qualify as actual investors, comply with all federal and local laws, and grant the government a perpetual easement across any land adjoining a beach or shoreline. \textit{Id.}

\textsuperscript{134} \textit{Id.} § 709. See \textit{King Christian Enterprises v. Virgin Islands}, 345 F.2d 633 (3d Cir. 1965) (building company not entitled to exemption; Tax Exemption Board acted properly when it refused to treat several of plaintiff's investments together for purposes of meeting the statute's requirement of minimum capital).
proved, the government issues a certificate in the nature of a contract which entitles the business to a series of tax exemptions and subsidies. The business, at its option, may choose to receive its benefits in as few as ten years or in as many as twenty years. Benefits for an additional five to ten years are available to those businesses which locate in specified "economically depressed" areas.

E. The Targeted Jobs Tax Credit

Congress, as part of the Revenue Act of 1978, amended the Internal Revenue Code to provide a targeted jobs tax credit to employers of qualified workers. The credit, which will remain in effect through the end of 1981, seeks "to focus employment incentives on those individuals who have high unemployment rates, even when the national unemployment rate is low." Accordingly, the Code lists seven groups of individuals, including the economically disadvantaged and the handicapped, who stand to benefit from the credit. Employers who hire members of these targeted groups may claim tax credits as follows: fifty percent of

135. V.I. CODE ANN. tit. 29, § 701(c) (Supp. 1979). In Vitex Mfg. Co. v. Virgin Islands, 351 F.2d 313 (3d Cir. 1965), the court ruled that because the certificate was in the nature of a contract, the language of the certificate should be construed against the government.

136. V.I. CODE ANN. tit. 29, §§ 713-715 (Supp. 1979). Eligible businesses receive exemptions from most real property, gross receipts, and excise taxes. Id. § 713(a). They also receive non-taxable subsidies, or rebates, of 90% of most income taxes paid to the Virgin Islands, and 90% of customs duties and other taxes paid on imported raw materials and component parts. Id. § 713(b).

137. Id. § 713(c). Businesses which elect a ten year period of benefits receive total exemptions and 90% subsidies annually. Those which elect a twenty year term receive 50% exemptions and 45% subsidies annually. A business may choose to receive its benefits for any number of years in between the two poles, with rates adjusted accordingly. Id.

138. Id. § 714(a).


141. Id. § 51(c)(4).


143. I.R.C. § 51(d)(1) provides, "An individual is a member of a targeted group if such individual is—(A) a vocational rehabilitation referral, (B) an economically disadvantaged youth, (C) an economically disadvantaged Vietnam-era veteran, (D) an SSI recipient, (E) a general assistance recipient, (F) a youth participating in a cooperative education program, or (G) an economically disadvantaged ex-convict." The categories are further defined in §§ 51(d)(2)-(9).
the first $6,000 of wages paid to the employee during the first year of his employment, and twenty-five percent of the first $6,000 of wages paid during the second year. Thus an employer receives a maximum credit of $4,500 per qualified employee over a two year period.

The credit, while it identifies targeted groups of individuals in need of jobs, fails to encourage the creation of jobs where they are most needed. The Kemp-Garcia plan seems preferable to the amended Internal Revenue Code. It proposes to bring jobs to many of the same groups, but plans to do so by creating the jobs, with as little red tape as possible, in the targeted areas. Under the current law, a young person who seeks employment as an "economically disadvantaged youth" must first prove to the satisfaction of a "designated local agency" that he is a member of a family whose income for the past six months has been less than seventy percent of the Bureau of Labor Statistics "lower living standard." On the other hand, under the Kemp-Garcia bill, he would only have to prove that he resides in the zone to ensure that he and his employer would enjoy the full benefits of the legislation.

F. Current Enterprise Zones In Great Britain

Enterprise zones are currently being developed in at least seven communities in Great Britain. The British program received a boost in 1979 with the appointment of Sir Geoffrey Howe, one of the originators of the enterprise zone concept, to the influential post of Chancellor of the Exchequer. The British program offers several major incentives to businesses willing to locate in a zone. For instance, every business in a zone receives an exemption from all real property and corporate income taxes. The government

144. Id. §§ 51(a)-(b).
145. Id. § 51(d)(3), (9).
146. Employers who hire up to half of their workers from areas outside a zone may still be eligible for Kemp-Garcia benefits. H.R. 7563, tit. IIA, sec. 211(d)(2)(C). See notes 200-07 infra and accompanying text for a discussion of the eligibility requirements under the Kemp-Garcia bill.
147. Dep't of the Environment, Press Release No. 51 (July 29, 1980) [Great Britain]. The sites for the zones, limited to approximately 500 acres each, include parts of London, Liverpool, Manchester, Newcastle, and Belfast. See also Unsworth, UK Eyes Setting Up 7 'Enterprise Zones,' J. Com., Oct. 29, 1980, § 4, at 1, col. 4.
148. See notes 7-8 supra and accompanying text for a summary of Sir Geoffrey’s plan.
149. Dep’t of the Treasury, Economic Progress Report, No. 121 (May 1980) [Great Britain].
has eased zoning restrictions and made planning procedures less complicated.\textsuperscript{150} It has also promised to "reduce to a bare minimum its requests for statistical information" from zone businesses.\textsuperscript{151}

The British zones are slated to run for ten years, subject to renewal.\textsuperscript{152} While the government's ultimate aim is to "bring new life back to these areas of economic dereliction,"\textsuperscript{153} it is still too early to gauge the success of the program. In conjunction with the Puerto Rican and Virgin Islands' programs, however, the British zones provide Congress with useful models for enterprise zones in America.

IV. Analysis of the Kemp-Garcia Bill

A. Designation of Zones\textsuperscript{154}

Under the Kemp-Garcia bill, local governments take the first step in deciding which areas should be designated as enterprise zones by submitting their applications to the Secretary of Commerce.\textsuperscript{155} Alternatively, a state government may apply on behalf of one or more consenting local governments.\textsuperscript{156} In instances in which the boundaries of an enterprise zone will extend beyond the jurisdiction of a single city or town, the second option may prove especially useful because it allows the state to take the initiative in seeking a designation. Under both options, however, a local government has the final word on whether or not an application will be submitted. As a result, no community will be saddled with an enterprise zone it never requested.

An applicant must meet several requirements in order to qualify for enterprise zone status. First, the entire area of the zone must fall within the jurisdiction of the government or governments

\begin{itemize}
  \item \textsuperscript{150} Id.
  \item \textsuperscript{151} Id. See section V infra.
  \item \textsuperscript{152} Dep't of the Treasury, Economic Progress Report, No. 121 (May 1980) [Great Britain].
  \item \textsuperscript{153} Id.
  \item \textsuperscript{154} This subject is dealt with in Title I of the Kemp-Garcia bill, "Designation of Private Jobs and Enterprise Zones." H.R. 7563, tit. I.
  \item \textsuperscript{155} Id. tit. I, sec. 101(a), subch. C, § 7871(a).
  \item \textsuperscript{156} Id. § 7871(a)(2). The first enterprise zone bill, H.R. 7240, did not provide this alternative.
\end{itemize}
designating the zone.\textsuperscript{157} Thus a zone may come under the jurisdiction of more than one local government, but only if each community consents to the designation. Second, the boundary of the zone must be continuous.\textsuperscript{158} A city can not use its poorest blocks to create a confusing checkerboard zone, but nothing in the Kemp-Garcia bill prevents a city from designating more than one zone if all other requirements are met. Third, at least 4,000 persons must live in the zone.\textsuperscript{159} The result of this politically attractive low threshold is that rural regions as well as inner city neighborhoods can qualify. A special provision is made for Indian reservations, which need not meet the population requirement.\textsuperscript{160} Fourth, levels of unemployment and poverty in the zone must be high enough to warrant the designation.\textsuperscript{161} The bill provides three options by which an applicant can satisfy the fourth requirement.\textsuperscript{162} Under option A, the requirement is met if at least thirty percent of the families residing in the zone live below the poverty level\textsuperscript{163} and unemployment for the past two years must have run at least twice the national average.\textsuperscript{164} Under option B, unemployment for the past two years must have run at least three times the national average.\textsuperscript{165} Under option C, at least fifty percent of the families residing in the zone must live below the poverty level.\textsuperscript{166} These are rigid standards, appropriately designed to restrict enterprise zones to the nation's most eco-

\begin{enumerate}
\item \textsuperscript{157} H.R. 7563, tit. I, sec. 101(a), subch. C, § 7871(c)(1)(A).
\item \textsuperscript{158} Id. § 7871(c)(1)(B).
\item \textsuperscript{159} Id. § 7871(c)(1)(C)(i). The bill does not indicate whether the population of the zone is to be measured by the last official census (which may be inaccurate in a poor community, especially if illegal aliens are present) or by some other means.
\item \textsuperscript{160} Id. § 7871(c)(1)(C)(ii). H.R. 7240 did not contain this provision.
\item \textsuperscript{161} H.R. 7563, tit. I, sec. 101(a), subch. C, § 7871(c)(2).
\item \textsuperscript{162} Id.
\item \textsuperscript{163} The Kemp-Garcia bill defines the poverty level as, "85\% percent of the average lower living standard income level determined annually by the Secretary of Labor and published by the Bureau of Labor Statistics." Id. § 7871(c)(3). H.R. 7249, by contrast, proposed using figures compiled by the Department of Commerce, Bureau of the Census to determine the number of families below the poverty level. H.R. 7249, tit. I, sec. 101(a), subch. C, § 7871(c)(2). According to an adviser to Rep. Garcia, the change was requested because Rep. Garcia believes that the Bureau of Labor statistics are more readily attainable. Telephone interview with Paul Bardack, Legal Adviser to Rep. Robert Garcia (Nov. 5, 1980).
\item \textsuperscript{164} H.R. 7563, tit. I, sec. 101(a), subch. C, § 7871(c)(2)(A). Unemployment figures may be derived from any source acceptable to the Secretary of Commerce. Id. § 7871(c)(4).
\item \textsuperscript{165} Id. § 7871(c)(2)(B).
\item \textsuperscript{166} Id. § 7871(c)(2)(C).
\end{enumerate}
nomically depressed areas.\textsuperscript{167}

An applicant must meet one final requirement. Every local government seeking federal approval of an enterprise zone must permanently reduce the effective real property tax rate\textsuperscript{168} in the zone by at least twenty percent.\textsuperscript{169} The entire reduction need not be made immediately; a locality has four years to make a "ratable" reduction after the Secretary of Commerce approves the designation.\textsuperscript{170} The requirement is made even less burdensome by a guarantee in the bill that the federal government will disregard the reduction in determining aid to state and local governments.\textsuperscript{171} The requirement, while commendable for its demand of a local commitment, is nonetheless troubling. As previously indicated, non-contractual perpetual exemptions are usually viewed by the courts as gratuities which may be terminated.\textsuperscript{172} Furthermore, the bill fails to recognize that many school districts rely heavily on local taxes for their funding and that some local bond issues are guaranteed by property taxes.\textsuperscript{173} Congress should consider an alternative to

\textsuperscript{167} A fact sheet on enterprise zones prepared by Rep. Kemp cites a House Information Services computer study which used 1970 data to estimate what proportion of the nation would be eligible for enterprise zone status. The study concluded that only one and a half percent of the nation's city dwellers live in areas which qualify, but that up to five percent of the total population of the United States is included when rural areas are added. J. KEMP, THE URBAN JOBS AND ENTERPRISE ZONE ACT: SOME QUESTIONS AND ANSWERS (1980). The controversy which surrounded the 1980 Census raised doubt about the accuracy and availability of any data derived from the Census.

\textsuperscript{168} The bill defines the effective real property tax rate as "the rate of the real property tax multiplied by the percentage of assessed value which is subject to such rate." H.R. 7563, tit. I, sec. 101(a), subch. C, § 7871(d)(2).

\textsuperscript{169} Id. § 7871(d)(1). The base rate which must be reduced by 20\% is the rate in effect when the application is submitted. Id.

\textsuperscript{170} Id.

\textsuperscript{171} Id. tit. I, sec. 101(c). H.R. 7240 did not contain this guarantee.

\textsuperscript{172} See note 79 supra and accompanying text. A foreseeable difficulty is that businesses will move to an enterprise zone relying on the permanent tax reduction, and the public will then call for an end to the favorable rates. The businesses could argue that the local government should be estopped from raising the tax rate, at least for a reasonable time, but the weight of authority would support a government contention that the abatement was a gratuity which could be terminated. See, e.g., Dodge v. Worcester, 129 Vt. 441, 282 A.2d 799 (1971); Grossman v. Wagner, 20 Misc. 2d 797, 192 N.Y.S.2d 557 (Sup. Ct. 1959); Miller v. Board of County Comm'rs, 79 Wyo. 502, 337 P.2d 262 (1959).

\textsuperscript{173} See generally United States Trust Co. v. New Jersey, 431 U.S. 1 (1977); Flushing Nat'l Bank v. Municipal Assistance Corp., 40 N.Y.2d 731, 356 N.E.2d 848, 390 N.Y.S.2d 22 (1976), supporting creditor's rights on municipal bond issues in the face of legislative attempts to alter the terms of the issues; see also Bond, Enhancing the Security Behind
this requirement.\textsuperscript{174}

Under the proposed legislation, once a local or state government submits its application, the Secretary of Commerce conducts a review to see if the applicant has fulfilled all the requirements for enterprise zone status.\textsuperscript{175} The Secretary is instructed to pay particular attention to the local government’s plan to make a permanent reduction in real property tax rates,\textsuperscript{176} apparently because the plan is the best available indicator of local commitment. The Secretary and the appropriate agencies within the Department of Commerce then have the exclusive authority to approve or reject the application.\textsuperscript{177} Once an enterprise zone is designated, it remains in effect for ten years.\textsuperscript{178} The clock for each zone begins to run on the first of January following its approval by the Secretary of Commerce.\textsuperscript{179} Thus all zones go into effect on the first of January and wind up on the last day of December, simplifying many tax returns in the zone. Exactly for which ten years a zone is in effect will vary from zone to zone.\textsuperscript{180}

In only one instance may a zone’s designation be revoked before its ten years have elapsed. The Secretary of Commerce has the authority to revoke a designation whenever a local government fails to comply “substantially” with the requirement for a permanent real property tax reduction in the zone.\textsuperscript{181} Few zones should be af-

\textit{Municipal Obligations: Flushing and U.S. Trust Lead the Way, 6 FORDHAM URB. L.J. 1 (1977).}

\textsuperscript{174} See section V infra.

\textsuperscript{175} The Secretary has the power to prescribe the form of the application and to require any information necessary to make a decision. H.R. 7563, tit. I, sec. 101(a), subch. C, § 7871(a)(2).

\textsuperscript{176} Id. The bill requires only that the local government make “assurances satisfactory to the Secretary” that it will actually reduce real property tax rates in the zone. \textit{Id.}

\textsuperscript{177} \textit{Id.} § 7871(a)(1). The bill does not indicate whether existing agencies in the Department of Commerce or some new office will be responsible for processing the applications.

\textsuperscript{178} Id. § 7871(b)(1). The original bill did not limit the term of a zone’s designation. H.R. 7240, tit. I, sec. 101(a), subch. C, § 7871(b)(1).


\textsuperscript{180} Because the Kemp-Garcia bill does not impose any deadlines for filing applications with the Secretary, some zones could begin on January 1, 1982 and remain in effect through December 31, 1991, while others could begin on January 1, 1983 and remain in effect through December 31, 1992. But within each zone, the same ten year period applies to all. \textit{Id.} Therefore, a business which opens during the eighth year of an enterprise zone is entitled to only two years of benefits. Congress should consider alternative measures which are better calculated to ensure the continued development of each zone. See section V infra.

\textsuperscript{181} H.R. 7563, tit. I, sec. 101(a), subch. C, § 7871(b)(2). The word “substantially” would
fected by this provision. If for some reason a local government cannot make the twenty percent cut in its tax rate, it can argue that a lesser cut "substantially" complies with the statute. Further, the bill provides that no revocation may go into effect until the last day of December following the first full year after the Secretary's decision.183 This period of one to two years should give local legislators ample opportunity to redesignate the zone by complying with the statute.

An area may seek a designation as both an enterprise zone and a foreign trade zone.183 In fact, the Kemp-Garcia bill encourages the dual designation by requesting the Foreign Trade Zone Board to expedite its review of applications submitted by enterprise zones.184 Sponsors of the bill hope that industries which employ unskilled workers to assemble foreign components into final products will want to locate in the dually designated zones.185 Even a foreign trade zone which does nothing but provide warehouses used for temporary storage,186 would contribute to the redevelopment of an economically depressed area.

seem to invite litigation. A 20% property tax cut in depressed areas should not be so onerous as to require a loophole.

182. Id. In prescribing the effective dates of a zone, the bill applies the same rules to revocations as to designations. Thus, despite a revocation, a zone can only be terminated on a December 31.

183. Id. tit. I, sec. 102. See Free Trade Zones—Worldwide, J. Com., Oct. 20, 1980, § 4, for a complete survey of free trade zones around the world and the benefits they offer. Free trade zones, referred to as foreign trade zones in the United States, are essentially "an importer's sanctuary from the host country's customs officers—a designated area, usually in or near a port, that is declared to be outside the host's customs territory." Id. at 1, col. 2. Of the some 355 free trade zones worldwide, approximately 60 are foreign trade zones located in the United States. Id. at 15, cols. 1-2. Zones vary in the United States, but they generally offer importers and exporters a place to store goods quickly and cheaply, without full customs formalities. Feldman, Trade Zone Growth Hitting Peak, J. Com., Oct. 22, 1979, § 4, at 1, col. 3.

184. Id. tit. I, sec. 102(1). The bill further provides that the Board should take into account the economic potential of enterprise zones when reviewing their applications. Id. sec. 102(2). The Board should also supply technical assistance to the enterprise zone applicants. Id. sec. 102(3).

185. J. Kemp, supra note 167, at 12.

B. Kemp-Garcia Incentives

The Kemp-Garcia bill provides several tax incentives and other inducements to draw businesses to enterprise zones. First, the bill amends the Internal Revenue Code to reduce social security payroll taxes for both employers and employees in a zone. The reduction, however, is not an automatic one. It applies only to "eligible employees," whom the bill defines as those workers who perform at least half their services in one or more enterprise zones. A further complication is that employees are eligible only for the duration of a payroll period; hence, a determination must be made at the end of each payroll period as to which employees are currently eligible for the reduction. These eligibility rules are unnecessarily burdensome. If their purpose is to exclude businesses which might operate "fronts" in enterprise zones to take advantage of the social security tax reduction, then the bill should provide a simpler means of gauging sincerity. Perhaps defining eligible employees as persons who work for zone businesses which employ a certain percentage of zone residents would be an easier, but equally accurate, test to apply.

Eligible employees do not all receive the same social security tax reductions under the Kemp-Garcia bill. The bill draws a distinction between those eligible employees who are under the age of twenty-one at the close of a payroll period and those who are twenty-one and over. The former are entitled to a social security tax reduction of ninety percent, while the latter are entitled to a fifty percent reduction. Thus the bill encourages employers to hire young workers. Given the high rate of

187. This subject is dealt with in Title II of the Kemp-Garcia bill, "Tax Incentives." H.R. 7563, tit. II.
188. Id. tit. IIA, sec. 201.
189. Id. tit. IIA, sec. 201(a), § 3126(b).
190. Id.
191. In another part of the bill, "qualified businesses" are defined to take residency of workers into account. Id. tit. IIB, sec. 211(b)(d)(2). See notes 202-07 supra and accompanying text. Congress should consider granting the social security tax abatements to "qualified businesses and their employees."
192. Id. tit. IIA, sec. 201(a), § 3126(a).
193. Id.
194. Id.
unemployment among teenagers in impoverished areas, this is an especially important and commendable feature of the bill.

The Kemp-Garcia bill expressly provides that the reduction in social security taxes “shall not affect the eligibility of any individual for benefits under the Social Security Act nor the amount or extent of such benefits.” This provision represents the major cost of the bill to the taxpayers. Every dollar of social security taxes not collected because of the Kemp-Garcia abatement must be replaced with general revenues. The bill instructs the Secretary of the Treasury to make a quarterly estimate of the amount of taxes lost due to the reduction and to transfer that amount to trust funds established for the benefit of the social security system.

A second tax incentive offered to lure businesses to enterprise zones is a reduction in capital gains tax rates for zone businesses. For corporations, the rate is reduced from twenty-eight percent to fifteen percent on sales and exchanges of qualified property. The Kemp-Garcia bill offers a series of definitions to aid in a determination of whether the lower rate applies. Qualified property includes both real and tangible personal property which is used predominantly by the taxpayer in the active conduct of a trade or business in a zone; it also includes any interest in a qualified business. For a business to be qualified, it must meet three requirements. First, it must actively engage in the conduct of a trade or business. Second, at least half of its employees must be qualified employees, who are defined as those workers per-

195. Id. tit. IIA, sec. 202. The original enterprise zone bill, H.R. 7240, did not contain this provision.
197. H.R. 7563, tit. IIA, sec. 203.
198. Id. The Secretary is also instructed to make appropriate adjustments for erroneous estimates in previous quarters. Id.
199. Id. tit. IIB.
201. H.R. 7563, tit. IIB, sec. 211(b)(d)(1). Homeowners in the zone also benefit from this definition. Real property sold or exchanged by individuals whose principal residence is in the zone is classified as qualified property for the purposes of the tax reduction. Id. tit. IIB, sec. 211(b)(d)(1)(B)(ii).
202. Id. tit. IIB, sec. 211(b)(d)(1)(C). The business interest may be in “a corporation, partnership, or other entity. . . .” Id.
203. Id. tit. IIB, sec. 211(b)(d)(2)(A).
204. Id. tit. IIB, sec. 211(b)(d)(2)(B).
forming substantially all of their services in one or more enterprise zones in the trade or business of their employer.\textsuperscript{205} Third, at least half of the business' qualified employees, on the average, must be residents of an enterprise zone.\textsuperscript{206} This final requirement, missing from the original enterprise zone bill, was added at the request of Representative Garcia.\textsuperscript{207} It should prevent businesses with little interest in hiring local workers from using enterprise zones as ten year tax havens.

Capital gains tax rates are also reduced for taxpayers other than corporations.\textsuperscript{208} Under the bill, non-corporate taxpayers' deductions on sales or exchanges of qualified property\textsuperscript{209} are increased from sixty to eighty percent of their net capital gain.\textsuperscript{210} The bill further exempts all taxpayers from minimum taxes on capital gains.\textsuperscript{211} As an added incentive for both corporate and other taxpayers, zone property for the purposes of capital gains taxes remains qualified after the zone's designation ends.\textsuperscript{212} The property loses its qualified status only after its first sale or exchange following the end of the zone's term.\textsuperscript{213}

A third major tax incentive available to enterprise zone businesses is a reduction in corporate income taxes.\textsuperscript{214} The reduction, which applies to the taxable income of all corporations classified as qualified businesses,\textsuperscript{215} is between fifteen and seventeen and one half percent of the present rate depending on the particular tax

\textsuperscript{205} Id. tit. IIB, sec. 211(b)(d)(3).
\textsuperscript{206} Id. tit. IIB, sec. 211(b)(d)(2)(C). The requirement includes a grace period to give new businesses time to hire zone residents. However, "for each taxable year after the first taxable year," the requirement must be met unless the business can show extenuating circumstances which satisfy the Secretary of the Treasury. Id.
\textsuperscript{207} Telephone interview with Paul Bardack, Legal Adviser to Rep. Robert Garcia (Nov. 5, 1980).
\textsuperscript{208} H.R. 7563, tit. IIB, sec. 212.
\textsuperscript{209} Qualified property is defined as it was for the purposes of the capital gains tax reduction for corporations. See notes 201-02 supra and accompanying text.
\textsuperscript{210} Compare I.R.C. § 1202(a) with H.R. 7563, tit. IIB, sec. 212(a)(1).
\textsuperscript{211} H.R. 7563, tit. IIB, sec. 213.
\textsuperscript{212} Id. tit. IIB, secs. 211(b)(d)(4), 212(a)(2). This exemption was not included in the original enterprise zone bill.
\textsuperscript{213} Id. tit. IIB, secs. 211(b)(d)(4)(B), 212(a)(2)(B). The bill wisely avoids offering an inducement to sell or exchange zone property toward the end of the ten year life of a zone.
\textsuperscript{214} Id. tit. IIC.
\textsuperscript{215} Qualified businesses are defined as they were for the purposes of the capital gains tax reduction. See notes 202-07 supra and accompanying text.
Clearly the savings are significant for both large and small corporations, but not as impressive as those attainable under the Virgin Islands or British programs. Because the reduction in corporate income tax rates will be of prime importance to most businesses contemplating operations in a zone, Congress should make certain that this incentive is adequate.

A fourth incentive, designed especially for small businesses, is an accelerated depreciation schedule. The schedule applies only to qualified businesses whose aggregate bases of property placed in service during the taxable year does not exceed $500,000. When the schedule applies, the business may use a three year straight line method of depreciation for all property placed in service during the taxable year. The current bill also allows a full investment credit on this property. These provisions not only simplify bookkeeping for small businesses, but also allow businesses to retain more of their earnings during their early years.

A fifth incentive further simplifies bookkeeping for small businesses in a zone. The bill provides that qualified businesses whose annual gross receipts in no prior year have exceeded $1,500,000 may choose to use the cash receipts and disbursements

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>I.R.C. rate</th>
<th>H.R. 7563 rate</th>
<th>Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>$25,000.00 and less</td>
<td>17%</td>
<td>14%</td>
<td>17.6%</td>
</tr>
<tr>
<td>$25,000.01 to $50,000.00</td>
<td>20%</td>
<td>17%</td>
<td>15.0%</td>
</tr>
<tr>
<td>$50,000.01 to $75,000.00</td>
<td>30%</td>
<td>25%</td>
<td>16.7%</td>
</tr>
<tr>
<td>$75,000.01 to $100,000.00</td>
<td>40%</td>
<td>34%</td>
<td>15.0%</td>
</tr>
<tr>
<td>$100,000.00 and more</td>
<td>46%</td>
<td>39%</td>
<td>15.2%</td>
</tr>
</tbody>
</table>

Congress should consider an incentive, such as a corporate tax credit refund, for zone businesses which have no taxable income.


Qualified businesses are defined as they were for the purposes of the capital gains tax reduction. See notes 202-07 supra and accompanying text.

H.R. 7653, tit. IID, sec. 231, did not contain this provision.

Qualified businesses are defined as they were for the purposes of the capital gains tax reduction. See notes 202-07 supra and accompanying text.
method of accounting. Further, any new business in a zone, no matter how large, may use the cash method during its first taxable year as a qualified business. The flexibility of the cash method and the relief it provides from the more complicated accrual method of accounting should be useful in attracting small businesses, which often cannot afford the services of outside accountants, to enterprise zones.

A final incentive relates to net operating loss carryovers. The bill amends the Internal Revenue Code to extend net operating loss carryovers from seven to ten years for all qualified zone businesses. The provision is intended to “give businesses an incentive to hang on through initial losses,” an important consideration in the long-range development of enterprise zones.

How much will all these incentives cost the taxpayer? Representative Kemp estimates that if half of the eligible areas in the United States were designated as enterprise zones, then the total amount of lost tax revenues could run as high as $1.5 billion annually. Few would argue that the cost, when compared to amounts spent on other urban programs over the years, is too high.

V. Recommendations and Conclusion

The current version of the Kemp-Garcia bill is legally sound. Its principal strength rests in the fact that it proposes to redevelop targeted areas with minimal amounts of government spending and oversight. Congress’ first concern, therefore, should be to retain the

226. Id. tit. IID, sec. 233.
228. J. KEMP, supra note 167, at 11.
229. Id. at 4-5. Rep. Kemp estimates the annual cost of the bill as follows: 1) social security tax reductions: $948 million; 2) capital gains tax reductions: $75 million; 3) corporate income tax reductions: $131 million; 4) accelerated depreciation schedule: $53 million; 5) cash method of accounting: $12 million; 6) extended net operating loss carryovers: negligible; 7) administrative costs: $19 million; 8) Foreign Trade Zones Board assistance: $2 million. Rep. Kemp cautions that these are rough estimates, but believes that they may be on the high side because they assume no reflow due to the incentives. Id.
230. The New York Times recently commented that even if the lost taxes amount to $1.5 billion annually, the cost “is still much less than existing urban grant programs and, in theory, some of the lost revenue would be offset by the taxes paid by the businesses and workers as they became productive.” Rosenbaum, Reagan Calls His Version ‘Urban Enterprise Zones,’ N.Y. Times, Nov. 23, 1980, § 4, at 2, col. 3.
virtues of the bill through the political bargaining that lies ahead. Although not every area will benefit directly from the bill, Congress must make certain that its incentives apply with full force to the particular areas and groups most in need of assistance. In addition, every attempt to burden zone businesses with unnecessary paperwork must be thwarted. Furthermore, Congress should continue to court the small businessman, an important factor in the growth of any community.231

The Kemp-Garcia bill deserves praise for not relaxing wage, safety, health, environmental, or fair labor standards in enterprise zones. Zone businesses which, despite all their tax breaks, can only operate by paying substandard wages or by excessively polluting the air need not be encouraged. In fact, Congress should include provisions in the bill, similar to those found in the Kennedy bill,232 which require zone businesses to maintain all federal and local standards.

Several changes to the Kemp-Garcia bill are in order. Congress should more clearly define which employers and employees are eligible to receive social security tax reductions.233 In designating a zone, Congress should not require a "permanent" real property tax reduction which it cannot guarantee.234 Instead, it should require a reduction only during the ten year period that the federal government can exert its influence in the zone. If local school budgets and bond issues are adversely affected by the ten year reduction, then Congress should be willing to supply the schools with extra funds and the bondholders with extra guarantees.

The current bill does not make the Commerce and Treasury Departments accountable for their decisions concerning which areas qualify as enterprise zones and which businesses are eligible for


233. See notes 188-91 supra and accompanying text.

234. See notes 168-74 supra and accompanying text.
exemptions. Although a certain amount of latitude is desirable, the departments should be required to file annual reports subject to Congressional review.\(^2\)\(^8\) Congress should also encourage the expedited judicial review of all contested enterprise zone decisions.\(^2\)\(^8\)

The Kennedy bill provided that businesses "relocating from one area to another" should not be entitled to the benefits of the program, although expanding businesses should be eligible.\(^2\)\(^9\) Congress should consider a similar clause to discourage businesses from relocating in enterprise zones solely to take advantage of Kemp-Garcia benefits. By requiring that "eligible businesses" be in the nature of either new or expanded operations, Congress could help preserve communities adjacent to enterprise zones.

The Kemp-Garcia proposals are closely related to the tax incentive programs already in effect in the Virgin Islands, Puerto Rico, and Great Britain.\(^2\)\(^8\) Clearly there are differences among the various programs, such as the incentives they offer and the regions they involve, but essentially their purposes and policies are the same. Congress should make a thorough study of these programs. It should conduct hearings in Puerto Rico and the Virgin Islands to discover what the successes and failures of their programs have been.

Finally, Congress should consider making enterprise zones even more attractive to developers. To supplement the incentives for businesses, incentives which would encourage new housing should also be weighed. A statement containing assurances similar to Britain's promise to "reduce to a bare minimum its requests for statistical information" from zone businesses\(^3\)\(^9\) would be a welcome addition to the bill. Furthermore, Congress should make certain that the maximum ten year period of benefits for each zone is adequate

\(^{235}\) Similar systems of accountability are used in Massachusetts and Alaska to monitor state development finance corporations. B. DANIELS & M. KIESCHNICK, DEVELOPMENT FINANCE: A PRIMER FOR POLICYMAKERS, PART II 47 (1979).

\(^{236}\) A business should not have to spend several years in court while a zone's term is running. Congress should consider a clause similar to the one governing the review of certain Federal Trade Commission decisions: "Such proceedings in the court of appeals [or district court in the case of Kemp-Garcia legislation] shall be given precedence over other cases pending therein, and shall be in every way expedited." 15 U.S.C. § 45(e) (1976).

\(^{237}\) S. 2088, 90th Cong., 1st Sess., §2.

\(^{238}\) See notes 116-38, 147-53 supra and accompanying text.

\(^{239}\) Dep't of the Treasury, Economic Progress Report, No. 121 (May 1980) [Great Britain].
to achieve real progress in the nation’s most impoverished areas. Congress may find it necessary to include renewal provisions, such as those in Britain, for zones which have not achieved complete success after ten years. Alternatively, a minimum period of exemption should be available to businesses which open after a zone is already several years old. Otherwise, virtually all development in a zone will take place during its first few years. Congress should promote the continued growth of these economically depressed areas and not foster “boom towns” which fade as quickly as they blossom.

The Kemp-Garcia bill proposes an approach to urban redevelopment which is new only in the sense that the federal government has never attempted anything like it before. Tax incentive programs have often worked well in the past. Now Congress has an opportunity to offer major incentives which should go a long way toward rebuilding the nation’s economically depressed areas. Representatives Kemp and Garcia have submitted a proposal which deserves the attention of Congress and the nation.

Robert W. Benjamin

240. See note 152 supra and accompanying text.