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USING INDUSTRIAL REVENUE BONDS TO OBTAIN PROPERTY TAX ABATEMENT FOR AN ECONOMIC DEVELOPMENT PROJECT IN KENTUCKY

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HOW CAN YOU OBTAIN PROPERTY TAX ABATEMENT IN KENTUCKY FOR AN ECONOMIC DEVELOPMENT PROJECT?

"abatement" == exemption or reduction in amount of property tax payable

- as a stand-alone incentive; or

- as part of a package of state and local incentives (e.g., KBIP, KEIA, TIF)

WAY #1

Property Tax Exemption for Manufacturing Establishments in a City

Section 170 of the Kentucky Constitution is entitled "Property exempt from taxation -- Cities may exempt factories for five years" and provides in pertinent part:

The General Assembly may authorize any incorporated city or town to exempt manufacturing establishments from municipal taxation, for a period not exceeding five years, as an inducement to their location.

Enabling statutes: KRS 91.260 (Louisville)
KRS 92.300 (Lexington other cities)

Property Tax Exemption for Manufacturing Establishments in a City

Limitations of Way #1:

(1) project must be in a city

(2) project must be a "manufacturing establishment"
$\neq$ corporate headquarters, service, retail, mining

(3) exemption must be an "inducement for location"

- new business in the city
- expansion of existing business, lest it relocate elsewhere
- relocation within a city, lest it relocate elsewhere

(4) duration of exemption no more than five years

(5) exemption applies only to city taxes

<u>Way #2</u> (problematic)

<u>Lease of Project from Nonprofit Economic Development Entity</u>

nonprofit economic development entity acquires the project and leases it to the for-profit company

- local economic development authority established under KRS 154.50 (acquisition of land for industrial development)

- nonprofit, §501(c)(3) corporation established by local chamber of commerce

- proponents of this structure argue that the project will exempt from property tax because the owner/lessor is a governmental body or a tax-exempt §501(c)(3) corporation

<u>However, there's this obstacle to Way #2:</u>

KRS 132.195. Assessment of possessory interest in tax-exempt real or personal property -- Lessee's liability.

(1) When any real or personal property which is exempt from taxation is leased or possession is otherwise transferred to a natural person, association, partnership, or corporation in connection with a business conducted for profit, the leasehold or other interest in the property shall be subject to state and local taxation at the rate applicable to real or personal property levied by each taxing jurisdiction

<u>But there is a Way #3:</u>

KRS 132.195. Assessment of possessory interest in tax-exempt real or personal property -- Lessee's liability.

(2) Subsection (1) of this section shall not apply to interests in:

(a) Industrial buildings, as defined under KRS 103.200, owned and financed by a tax-exempt governmental unit or tax-exempt statutory authority under the provisions of KRS Chapter 103, the taxation of which is provided for under the provisions of KRS 132.020 and 132.200 ….

Way #3

Property Tax Abatement via an IRB Issue (1)

- City, county, the Kentucky Economic Development Finance Authority (KEDFA), an air board, or a riverport authority (*Issuer*) issues industrial revenue bonds under KRS Chapter 103 to acquire an economic development project (*Project*)
    - Project can include land, land improvements, buildings, machinery, and equipment
- Issuer holds legal title to the Project and leases it to the for-profit company (*Company)* for a term equal to the term of the bonds
    - Maximum term of the bonds: 30 years (KRS 103.220(1))

Property Tax Abatement via an IRB Issue (2)

- The Project is exempt from state and local real and personal property tax as long as the Issuer holds title to the Project and leases it to the Company, subject to state leasehold tax at the rate of $0.015 per $100 of assessed value

- Prior to the issuance of the bonds, the Issuer and the Company must apply to KEDFA for its approval of the state property tax abatement.

- The local taxing authorities, and KEDFA, may require payments in lieu of taxes (PILOT payments) for all of the property taxes that otherwise would be due

  - the local school district, and KEDFA, usually require PILOT payments equal to 100% of the school taxes that otherwise would be due

  - local fire protection districts and other special taxing districts (e.g., library, board of health) may negotiate for PILOT payments

  - state, and county and city, if they favor the Project, usually do not (but may) require PILOT payments

Property Tax Abatement via an IRB Issue (3)

- IRB property tax abatement is available regardless of whether the interest on the bonds qualifies for federal income tax exemption
- If the Company does not need or want to use an IRB as its external financing for the Project, an affiliate of the Company (e.g., parent company, sister company, individual controlling shareholder) can buy the bonds and thereby make the property tax abatement available

Property Tax Abatement via an IRB Issue (4)

- Since 7/15/2002, property tax abatement via an IRB requires the prior approval of KEDFA (KRS 103.210).
- Issuer and Company jointly apply to KEDFA on a form prescribed by KEDFA
- $500 application fee, usually paid by Company
- application must include the Issuer's inducement resolution or bond ordinance for the bond issue
- KEDFA considers the application at its monthly public meeting

Property Tax Abatement via an IRB Issue (5)

- KEDFA application evaluation criteria:
  - number of full-time jobs preserved or new full-time jobs created
  - average hourly wages and benefits for those jobs
  - amount of capital investment in the project
  - local unemployment rate in the county of the project
  - other state incentives for the project
  - relocation within Kentucky?
  - new projected tax revenues from the project
  - support of the project by the city, county, and school district
  - PILOT agreements