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The Pros and Cons of TIFs

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In Maine, and many other states, TIFs have a long history, but we should note that they take many forms with varying degrees of appropriateness and fairness.[1] At the same time there is almost always a high level of misinformation, misunderstanding, and naivete permeating the public debate with respect to the wisdom and need for a particular TIF proposal that has been put on the table by a particular developer/governmental entity, involving a particular geography and time frame. TIFs are not a generic item— every TIF proposal must be examined in its context; some make a great deal of sense and should almost certainly be approved; others are little more than a massive and unfair give-away of scarce tax dollars to wealthy corporations that do not need, and have no legal claim to these public subsidies.[2]

Before going further it may be useful to define what a TIF is: The acronym stands for Tax Increment Financing. Such financing assumes that a developer is prepared to make a capital investment in a property (a new store, mall, office building, or factory will be built— jobs will be created or retained); this investment will in turn increase the value of the property, which in turn will increase the property taxes collected from that property. This increase in property tax revenue, the "tax increment" arising from the new investment, would normally become part of the general fund revenues of the municipality in which the property is located. A TIF, on the other hand, takes a portion (or all) of this increment, for however long the TIF agreement specifies, and uses it to finance (in whole or in part) direct or indirect project costs/expenditures.

Indirect project costs/expenditures usually refer to the infrastructure needs of the new project, i.e., the extension or upgrading of water, sewer, or power lines— street improvements, building rail or interstate linkages, a new interchange— brown-fields cleanup— parking improvements— etc. TIFs of this character (whether undertaken by a municipality or the state) go back many years and raise relatively few eyebrows today. A reasonable sharing of these costs between the developer and the funding governmental entity can usually be hammered out. The cost of the governmental share will be borne by the "tax increment" created by the new capital investment. The improvements created are usually owned by the public, serve legitimate public interests (beyond those of the developer) and/or ameliorate conditions that the public has a duty to correct. The fact that these improvements have been triggered by, and benefit, a particular developer does not alter their public character.

Far more controversial, however, is the growing use of tax increment revenues to finance some portion of the corporate developer's direct costs, his capital investment in the project. This is done by returning a part of the "tax increment" each year directly to the developer (for as long as 10, 20, 30 years) thereby reducing over time his net capital investment in the project. This latter type of TIF, though of relatively recent origin, is increasingly being used in Maine and a number of other states. It is a payment of tax dollars to the developer that would otherwise

remain part of the municipality's general fund revenues. It is correctly seen by economists, accountants, and the courts as a tax expenditure, a direct subsidy by government to the corporate developer.

Proponents of this latter type of TIF argue that this subsidy is often critical, a necessary inducement to obtain the corporate developer's commitment to the project. Without it, they argue, the developer might not invest in the project being discussed, in which case there would be no increase in property valuation, and thus no increase in (no increment of) property tax revenues. This argument, whether stated bluntly or more coyly by a particular corporate developer, contains an implied threat that the developer will not undertake a project in a particular town or state unless a generous TIF is provided— how generous remains to be seen. Many corporate developers are actively (and simultaneously) engaged in negotiating TIF options with (whipsawing) nearby municipalities and/or states to get the best TIF deal possible.

This corporate playing off of one municipality against another, one state against another is a cynical TIF strategy (little more than extortion) that is increasingly engaged in. It plays on the hopes and fears of municipal and state officials. Few of these officials can resist competing in a race to give away more than those they are competing with— each of these municipalities/states needs, wants, is constantly in pursuit of new capital investment and the accompanying jobs, increased tax base, etc. that the new capital investment will give rise to. The winning municipality/state believes that something (the tax increments minus the TIFs) is better than nothing. But even the winner has lost the tax revenues that it has agreed to give away in TIF payments; the losing municipalities/states can contemplate whether they should have upped the ante— whether in the future they should give away a larger share of scarce tax dollars by way of direct subsidy TIF payments. Only the corporate developer wins— he can bank the TIF subsidies (for however long they extend into the future); he has reduced the capital investment costs of his project.[3]

Viewed on a larger (a national) scale, taxpayers are the biggest losers in these direct TIF payments (subsidies) to corporate developers. In the aggregate direct subsidy TIFs (municipal and state) represent a massive transfer of scarce state and local tax dollars to corporate developers to finance, in part, private (for profit) capital investment. Residual taxpayers must pay more (or services must be reduced) to offset these corporate welfare payments— payments which often go to large, wealthy, Fortune 500 corporations who do not need, and have no equitable claim to these subsidies.[4]

In re direct subsidy TIFs, the critical flaw in municipal/state official's reasoning is their failure to acknowledge and accept the data provided by industrial location specialists. Almost without exception the data shows that TIF's, and/or other forms of governmental subsidy, are not a significant factor in business location or expansion decisions. Most businesses expand in, or move to, an area because they anticipate making money in that location— it's as simple as that.

Location and expansion decisions are driven by profit margins which are in turn influenced by a host of underlying economic factors and realities— these factors include the availability and cost of labor, the availability and cost of needed raw materials, transportation costs, access to new markets and/or the potential for increased market share in the new location, quality of life considerations, the quality of public and/or private schools in the area, or some combination of all of these factors. Governmental subsidies do not significantly change or alter these underlying

social and economic realities.

In short, there is no empirical evidence to support governmental economic development assumptions (i.e. that subsidies will lure corporations to a municipality/state), or veiled corporate threats to locate elsewhere, that underlie corporate efforts to obtain TIF-type subsidies. Of course, if infrastructure or capital investment costs incident to any new business venture, or business expansion, can be reduced by a no-strings government subsidy to the corporation, the corporation will certainly accept it. Indeed, as noted above, corporations are not above manipulating governments to obtain as much subsidy as the traffic will bear— **but** this is a windfall, an increase to the margins of profit. The subsidy did not make the deal— business factors, anticipated profit margins— these are the factors that make or break the deal. The willingness of major corporations to relocate when the underlying business climate changes (often leaving large TIF subsidies on the table) underscores the truth of this reality.

The use by municipalities/states of direct subsidy TIFs should also be examined from the standpoint of tax fairness. Giving a Walmart, Cabellas, Home Depot, a General Motors plant, or any large corporation a TIF to come to your municipality/state is unfair to the hundreds of other firms (to say nothing of homeowners) who live in the community. The latter have not asked for and will **not** receive a TIF subsidy. Many of these firms have made long-term commitments to the municipality they are in. Many are expanding, making new capital investments, creating jobs–all without seeking or receiving any tax subsidy.

These firms (and homeowners) are made poor twice— first, they do not get the benefit of a TIF subsidy. Second, because any TIF subsidy given (to Walmart, or whomever) must be made up by the residual taxpayers in the community, these residual taxpayers (firms and homeowners alike) will wind up paying higher taxes than they would otherwise have to pay (or they will get fewer services). It's irrefutable, TIF's by definition benefit only a few corporations–the rest of us are left holding the bag. One would think this unequal tax treatment, this unfairness would shock us— it seemingly does not.

Summarizing to this point: It is important that we see and understand the difference between so-called "infrastructure TIFs and "direct subsidy" TIFs. A case can be made for the first type of TIF— there is almost no justification for the latter type of TIF. Reducing the capital investment costs of private developers is not generally the business of government; it is not usually seen as an appropriate use of taxpayer dollars.

But notwithstanding my views both types of TIF are likely to continue to be used in the foreseeable future. The question then becomes— how do we avoid the abusive use of TIFs? What limitations on their use can/should be put in place to protect the public fisc, to maintain a semblance of fairness in our systems of taxation. The remainder of this paper will lay out some useful TIF safeguards, some protections that (if adopted) will make TIFs less of a runaway train, less of an abuse of state and local taxing power than they now are.

TIF Safeguards: As **a first step,** some "caps" (an upper limit on total TIF disbursements to a single corporation) can/should be put in place. Capping strategies must keep in mind the size of the capital investment proposed to be made in a given property and the time-frame for completing the project. This will enable an estimate of the tax increments over the next 5,10, 20 years to be made. Governments (state/municipal) then should determine what share of these

increments (for whatever defined period of time they deem appropriate) they are prepared to give away as an incentive to the developer to move ahead with the project. This can be stated as a percentage of total tax increments for the defined time period, or in an absolute dollar amount.

An argument can be made that the TIF share should be greater in settings where it will be used primarily to clean up a site and/or to make needed infrastructure improvements, as opposed to simply reducing the developer's capital investment costs. The level of a TIF "cap" and whether infrastructure TIFs should be favored over direct subsidy TIFs are decisions elected officials must make. But a "cap"— an upper limit for any/every project that receives TIF benefits can/should be fashioned by the sponsoring governmental body at the outset.

Capping strategies can be fine-tuned. For example, in cases where the TIF will be used to clean up a site, or to meet infrastructure needs, it makes sense to front end load the TIF— a high percentage of the tax increment, but no more than say 75% for a shortened time period— say three, five, seven years may be appropriate. At that point, a reduced level of TIF commitment say 25% for an additional three, five, or seven years (or until the upper limit on total TIF disbursement for this project has been reached) is sufficient.

In cases where the TIF is largely (if not totally) a direct subsidy to the developer, (a return of a portion of the developer's capital investment in the project) it may be prudent to pay out the TIF disbursement at a lesser rate over a longer period of time, say 40% over eight, ten, or twelve years until the total TIF commitment has been honored. This will enable the granting governmental unit to evaluate whether collateral promises of the developer, i.e., as to full build out, total capital investment, new employment, etc. have been met. If they have, fine— the TIF commitment should be honored. But if they have not, a pro-rata reduction of future TIF payments and/or a recovery of TIF payments already made, seems in order.

A second TIF safeguard (beyond "caps") that can/should be in place is some sort of "need" or "means" test for those who seek TIF benefits. We impose similar limitations on almost all individuals who would qualify for small business or student loans, welfare benefits. Corporations that seek TIF benefits should be treated no differently. Large state, national, or multi-national corporations that have millions of dollars in total assets, retained earnings, or annual profits can/should be declared ineligible for TIF benefits. Eligibility cut-off levels need not be determined here–the important point is that we accept the principle. Some firms do not need and have no just claim for a TIF subsidy.

A third TIF safeguard that can/should be put in place would make explicit the underlying theory of TIF's. These capital investment inducing subsidies, are intended to stimulate job growth and/or to retain existing jobs in the state/municipality— that's the "public purpose" that justifies this use of taxpayer money. The magnitude of a TIF should be commensurate with the anticipated job growth or job retention, and if promised employment levels do not materialize within stipulated reasonable time-frames, the TIF should be ended or significantly scaled back. In the same vein, if a corporation that received TIF benefits goes out of business, or moves to another state/municipality within a predetermined time frame, (at a minimum, the time period for TIF payments stated in the original TIF agreement) all, or a significant portion (as much as possible) of TIF monies paid to the developer should be recovered.

In short, a TIF commitment should be honored only insofar as the developer's short and long-

run job creation or job retention promises are substantially met. All job commitment, TIF reduction, and TIF clawback provisions can/should be spelled out (defined with reasonable precision) in any/all TIF agreements. Corporations should not be allowed to renege (with impunity) on employment promises made, and/or to simply take the money and run.

A fourth TIF safeguard that seems long overdue can/should end the practice that (in Maine) has come to be called "double dipping". Double dipping occurs when a corporation qualifies for TIF reimbursements of taxes paid from both a municipal government and the state level of government. Corporations that qualify for more than one such reimbursement program should be required to elect which they will exercise— presumably they will opt for the most advantageous. Fine. But they should be barred from pyramiding (participating in more than one) TIF reimbursement program. Alternatively, they could be allowed to participate (on a pro-rata basis) in more than one such program, but be barred from receiving in any tax year, or in the aggregate, an amount greater than the annual and total capped reimbursement limits suggested above.[5]

A fifth change in our thinking with respect to TIFs would stop seeing direct subsidy TIFs as one-directional, outright grants of scarce tax dollars to private corporations, with no expectation of a return. Direct subsidy TIF payments are more appropriately seen as public investments in private entrepreneurial risk-taking. The investment may be needed at an early start-up stage; in theory, it will leverage private investment and/or bank loans; it shows community support for the proposed project. But just as private investors demand and obtain a return on their investment, so too should the public look for a return on (and/or some form of participation growing out of) its investment.

This could take any of several forms: the TIF beneficiary may at some point be in a position to provide services that the municipality needs and would otherwise have to purchase–TIF payments should be treated as a credit against the fair market value of these services. Alternatively, TIF payments could be treated as the acquisition of an equity position in the benefitted firm–an equity that would grow over time as total TIF payments increased. Another approach would give the municipality a stipulated level of stock options for each year of TIF payments. The municipality could also be given the right to treat TIF payments as a type of loan to be repaid, with interest, when and if, profit margins of the benefitted firm reach a certain level. There may well be other options–but the key here (the change in our thinking) is to begin getting something back for the public's investment. Municipalities should end the policy of getting nothing for their considerable investment of taxpayer money. Instead, they should adopt a policy that says: "If we help, and if you succeed, we get to share in that success." This is the mind-set of all private investors in the marketplace–why should governments (when they invest tax dollars) settle for anything less?[6]

A last change or protection from TIFs that should be put in place is one that separates state and local TIF funding policies aimed at industrial development from state school aid funding and/or funding mechanisms for other governmental units (counties, special districts, etc.). In many states, present municipal/state TIF funding mechanisms have fiscal consequences that skew (often unfairly) school district, county government, and special district funding mechanisms. This should not be the case— these are correctable problems.

In Maine, for example, state law (designed to encourage municipal TIFs) allows TIF

generated tax increments to be omitted in calculating state school aid; this allows municipalities that grant TIFs to get more school aid than their assessed valuations would otherwise dictate.[7] Given the fixed nature of total state school aid monies from year to year, it follows that school districts serving (non-TIF granting) municipalities receive less school aid than they otherwise would. Adding insult to injury, these latter school districts are almost certainly educating some of the children of families/employees drawn to the area by the TIF induced project/development. These inequities continue for however many years the TIF runs. Why non-TIF granting municipalities (and school districts serving these municipalities) are not up in arms over this unfair forced contribution to state/municipal TIF policies is a mystery to me— one suspects they are largely unaware of the unfairness being foisted upon them. But, as noted above, this is an unfairness that can/should be corrected.

State law can/should make clear that TIF granting municipalities are free to give away to developers as much or as little of TIF generated tax increments as they choose, but that the state will no longer gerrymander the annual assessed valuation rolls in municipalities that make TIF disbursements. If TIF disbursements give rise to increased assessed valuations in a municipality, state school aid monies will almost certainly go down.

Alternatively, if states want to encourage municipalities to make TIF grants using strategies that have a negative effect on the level of funding received by overlapping or surrounding governmental entities (school districts, counties,[8] etc.) they can/should utilize general fund revenues (direct appropriations) to fiscally save whole these political entities. In short, the furtherance of municipal/state TIF policies should not be allowed to adversely affect non-TIF granting municipalities or other units of local government.

In Conclusion:

It is unlikely that all of these TIF safeguards and limitations will be enacted in any state; but considerations of tax fairness, coupled with revenue shortfalls facing most state and municipal governments, suggests that at least some of these measures should be put in place. Most of the changes will require amendments to state legislation. Municipalities cannot be expected to act unilaterally. Even if they agree wholeheartedly with the ideas presented here, to do so would simply place them at a competitive disadvantage vis-a-vis other municipalities in their state. In sum, states must take the lead in fashioning a more balanced, a less abusive use of TIFs. One can only hope this leadership will be forthcoming— that the excesses and unfairness, particularly of direct subsidy TIFs, will prompt changes along the lines suggested.

Endnotes

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1. This paper draws heavily on two earlier papers, *A Primer on TIFs— Parts I and II*, published in the Maine Lawyers Review on January 9th and 23rd, 2002. These papers focused largely on Maine's experience with TIFs.

2. For example, the Walmart Co., one of the nation's wealthiest corporations, has a long history of successfully utilizing its economic muscle, and its flexibility in making siting decisions, to extract TIF benefits and other governmental tax subsidies. Their actions have been extensively documented by organizations like Good Jobs First, that track the growing use of TIF and other

forms of tax subsidy to wealthy corporations, see Mattera & Purinton, *Shopping for Subsidies: How Walmart Uses Taxpayer Money to Finance its Never Ending Growth* (2004) and Mattera, *Shifting the Burden for Vital Public Services: Walmart's Tax Avoidance Schemes* (2011).

3. The above descriptions of infrastructure and direct subsidy TIFs involves the municipal level of government, and redirects increased property tax revenues to offset some portion of capital investment and/or infrastructure costs arising out of, and arguably meeting the needs of, the particular project being built. Many state governments also have TIF programs which allocate a portion of increased sales and/or income tax revenues to offset project infrastructure or capital investment costs. These state TIFs further reduce the developer's share of project costs. As with municipal TIFs, these state "tax increment" payments vary widely (from state to state, and often from project to project) in amount and duration. These tax increments are also said to both derive from, and induce, the developers new capital investment within the defined TIF area.

4. See Time Magazine, Special Report, Corporate Welfare by Donald Bartlett and James Steele, published in 4 installments Nov. 9, 16, 23, & 30, 1998. The lead (Nov. 9th issue at pg. 37) rhetorically asks: "How would you like to pay only a quarter of the real estate taxes you owe on your home? And buy everything for the next 10 years without spending a single penny in sales tax? Keep a chunk of your paycheck free of income taxes." Homeowners and small businesses do not receive these benefits, but TIFs (characterized as "investment incentives") provide these type of benefits (and more) to the wealthiest corporations in America.

5. Maine allows the pyramiding of TIF reimbursement programs; it has created both municipal and state TIF-type reimbursement programs that focus on property tax payments made; in some cases the unintended consequences are absurd, i.e. total reimbursements that exceed the total amount of property taxes paid in a given year. In states that allow pyramiding "triple dipping", or more, (the reimbursement of property, sales, and income taxes) becomes possible. Statutory limitations along the lines suggested here seem necessary to curb these types of excess.

6. It should be noted that recently enacted federal legislation, the TARP bailout, took this exact approach. Though not all TARP bailout funds were repaid to the federal government (some losses were real), in most cases the feds got back a significant portion of funds committed to these private entities— bailout monies were treated as repayable loans, bore interest rates, and/or gave the feds an equity-type interest in the receiving entity. In more than a few instances the feds actually profited, as bailed out firms moved from near bankruptcy, to recovery, to profit making.

7. This is because state school aid (often called "equalization aid") is distributed inversely to equalized municipal property tax base resources. Municipalities with a lower property tax base get more per pupil state school aid than municipalities with a larger property tax base. This is done to narrow the fiscal disparities (and thus the educational programs) between property tax poor and property tax rich school districts. Maine's TIF policies, obviously, distorts these school aid equalization policies.

8. In Maine, a large share of the cost of county government is borne by property taxes apportioned to each municipality in a county on the basis of equalized property valuations. At the same time Maine allows TIF generated assessed valuations to be omitted in calculating a

municipality's tax base. This skewing of municipal equalized assessment rolls enables TIF granting municipalities to pay less than their fair share of county government costs. Municipalities that do not grant TIFs wind up paying more than they should. This type of unfairness is not unique to Maine-it exists (in varying form) in many other states-the statutory changes suggested correct these situations.