CRC NOTES

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Can Dedicated Millages and Tax Increment Financing Coexist in Michigan?

Since 1975, Michigan cities, villages, and townships have been able to "capture" taxes levied by overlapping jurisdictions for economic development purposes in a narrowly defined geographic region of their municipalities. Despite occasional protests from those governmental entities having their tax revenues captured, the number of cities, villages, and townships with tax increment financing (TIF) authorities has grown and the number of economic development authorities that permit tax increment financing has increased. Now, with a high profile governmental entity receiving less tax revenues than anticipated because of this practice, it may be time for policy makers to ask hard questions about the appropriateness of this economic development tool.

A January 21, 2013, Detroit Free Press article documented the Detroit Zoo's frustration with Wayne County communities skimming a portion of the tax revenues raised by the zoo's 0.1 mill property tax levy.[1] That article was followed the next day by editorials in both the Detroit Free Press[2] and The Detroit News[3] chiding those Wayne County communities for diverting tax dollars from their intended purposes.

The current opposition to tax increment financing appears related to the ability of TIF authorities to capture new taxes, or tax increases, enacted after the tax increment financing districts were established (with the Detroit Zoo and in other jurisdictions where the ability to capture new millages has been challenged).

What is tax increment financing?

The purpose of tax increment financing authorities (used generically to include all of the authorities authorized to use TIF financing) is to halt declines in property values and attempt to increase property tax valuations by promoting economic growth in the applicable districts. The authorities prepare plans that are designed to stimulate economic growth and revitalize a development area(s) within the boundaries of the authorities. The law permits the municipalities, through these authorities, to acquire a portion of the property tax levy of all the taxing jurisdictions within the boundaries of the authorities (including, but not limited to, county taxes, locally levied school taxes, intermediate school district taxes, community college district taxes, and taxes levied by special authorities for libraries, fire protection, parks, ambulance, etc.).

The funds captured by the TIF authorities in each development area are used to finance the implementation of that area's development plan. The amount of the property taxes that the authorities may acquire varies from year-to-year, and is dependent on the annual change in the value of the property within the development areas, the total tax rates, and the portion of the tax increment needed to finance the development plan.

Under a tax increment financing plan, a base year value is established for the development area. The base year value, called the "initial assessed value," is the taxable value (TV) of all the taxable property within the boundaries of the development area at the time

[1] Detroit Free Press, January 21, 2013, Wayne County communities keeping some zoo tax money for downtowns, www.freep.com/article/20130121/NEWS05/301210077/Wayne-County-communities-keeping-some-zoo-tax-money-for-downtowns

[2] Detroit Free Press, January 22, 2013, Cities diverting zoo tax funds should stop defying the will of voters, www.freep.com/article/20130122/OPINION01/301230004/1302/NLETTER10/Editorial—Cities-diverting-zoo-tax-funds-should-stop-defying-the-will-of-voters?source=nletter-NEWS-FREEP-top_stories_5am

[3] The Detroit News, January 22, 2013, Taxation by misrepresentation, www.detroitnews.com/article/20130122/OPINION01/301220317/1008/?source=nletter-news

To illustrate a hypothetical example, imagine that a commercial property is located within the boundaries of the City of Nowhere DDA, and that in 2000, the DDA implemented a tax increment financing (TIF) plan. The TIF plan stipulated the "capture" of any increase in property taxes levied above and beyond the 2000 levy. At that time, the taxable value of the property was $500,000 and the non-homestead tax rate in City of Nowhere was 64.6445 mills, or approximately $65 per $1000 of taxable value. Assume this tax rate has been constant from 2000 to the present. This rate includes taxes that support the general operations of the city, the county, local schools, the intermediate school district, the community college, a parks authority, the county transportation authority, and the city debt obligation and State Education Tax.

The Nowhere DDA is prohibited from capturing tax revenues levied for the State Education Tax (SET) and the city debt obligation. In Nowhere, a total of 19.1129 mills are levied for the purposes of the SET and the city debt. Therefore, the Nowhere DDA may only capture the increased revenue from 45.5316 mills, or about $46 of the $65 per $1,000 of taxable value that are paid in taxes annually.

Assume the taxable value of the property grows,[1] so the amount paid in taxes each year also increases. The total taxes paid by the property owner are represented in the third column below. The annual amount of non-SET and non-debt taxes "capturable" (the 45.5316 mills) since 1995 is represented in the fourth column. The last column, "Amount Captured by the DDA," is equal to the difference of the amount of captured taxes paid each year and the amount of capturable taxes paid in 1995 when the Nowhere DDA implemented the tax increment financing plan.

By 2012, the Nowhere DDA will have "captured" over $49,000 in tax revenues from non-SET and non-debt taxes levied on the commercial property. However, the property owner is not directly impacted by the TIF plan. Property taxes are paid as usual; the only difference is that a proportion of the revenues raised from the property go to the DDA for economic development purposes instead of the other local taxing jurisdictions for education, parks and transit purposes.

1 Year	2 Taxable Value	3 Total Taxes Paid *(64.6445 mills * every $1,000 of taxable value)*	4 Taxes Subject to Capture *(45.5316 mills * every $1,000 of taxable value)*	5 Amount Captured by the DDA *(taxes subject to capture - $22,766)*	6 Taxes Captured as Percent of Total Taxes Paid
2000	$500,000	$32,332	$22,766	—	0.0%
2001	514,000	33,227	23,403	$637	1.9%
2002	528,392	34,158	24,059	1,293	3.8%
2003	542,659	35,080	24,708	1,942	5.5%
2004	551,341	35,651	25,103	2,338	6.6%
2005	561,817	36,318	25,580	2,815	7.8%
2006	579,795	37,481	26,399	3,633	9.7%
2007	598,348	38,680	27,244	4,478	11.6%
2008	607,323	39,260	27,652	4,887	12.4%
2009	621,292	40,163	28,288	5,523	13.8%
2010	635,582	41,087	28,939	6,173	15.0%
2011	656,556	42,443	29,894	7,128	16.8%
2012	680,848	44,013	31,000	8,234	18.7%
Total		$489,873		$49,081	

[1] As part of Proposal A of 1994, the Michigan Constitution was amended to create a new measure of property value—taxable value. The Constitution provides that the taxable value for each parcel of property, adjusted for additions and losses, shall not increase each year by more than the increase in the immediately proceeding year in the general price level (CPI), or 5 percent, whichever is less, until ownership of the parcel of property is transferred. The maximum CPI increases allowable under Proposal A for years 2000-2012 are accessible at: www.crcmich.org/Almanac/Taxes/propvalu.htm.

the tax increment plan is adopted. The increase in the TV of the development area above the base year TV is called the "captured assessed value." All property taxes levied on the captured assessed value in subsequent years can be used by the authorities to finance the area's development plans.

Development plans prepared by a TIF authority, including plans that provide for tax increment financing, must be approved by the governing body of the municipality. Before approving a development plan, the governing body must hold a public hearing and determine if the plan constitutes a public purpose. If the plan provides for tax increment financing, the governing body must provide a reasonable opportunity for the affected taxing jurisdictions to express their views regarding the tax increment financing plan.

Annual tax increment financing revenue may be used directly to finance development plans or pledged to pay the principal and interest on tax increment bonds. A maximum of 80 percent of the anticipated tax increment revenues available in any one year can be pledged to repay tax increment bonds.

The Prevalence of Tax Increment Financing Authorities

While tax increment financing was initiated to serve a narrow purpose, the number of authorities that permit its use has grown, the narrow purposes that may be served by various types of authorities have increased, and the number of local governments that have established these economic development authorities has grown as well. Starting with the enactment of Downtown Development Authorities (DDAs) in 1975, the legislature has incrementally expanded the number of authorities permitted to capture property tax revenues to Tax Increment Financing Authorities (TIFAs), Local Development Financing Authorities (LDFAs), Brownfield Redevelopment Authorities (BRAs), Historic Neighborhood Tax Increment Financing Authorities (HNTIFAs), Corridor Improvement Authorities (CIAs), and Water Resource Improvement Tax Increment Finance Authorities.[4] Information about these entities can be found in CRC's **Survey of Economic Development Programs in Michigan** last updated in 2007.[5]

Use of these economic development tools is common. The 2007 CRC report shows that as of 2005: 210 cities, villages, and townships (CVTs) had DDAs; 87 CVTs had TIFAs; 98 CVTs had LDFAs; 261 CVTs had BRAs; 63 CVTs had HNTIFAs; and an unknown number of communities had CIAs. (WRITIFAs were enacted in 2008, after publication of CRC's 2007 paper.)

[4] DDAs PA 197 of 1975, MCL 125.1651; TIFAs PA 450 of 1980, MCL 125.1801; LDFAs PA 281 of 1986, MCL 125.2151; BRAs PA 381 of 2000, MCL 125.2651; HNTIFAs PA 530 of 2004, MCL 125.2841; CIAs PA 280 of 2005, MCL 125.2871; WRITIFAs PA 94 of 2008, MCL 125.1780.

[5] CRC Report #347, **Survey of Economic Development Programs in Michigan**, 2nd Edition, June 2007, www.crcmich.org/PUBLICAT/2000s/2007/rpt347.pdf

The Legality of Tax Increment Financing

As far back as 1986, CRC was voicing concern over the legality of tax increment financing.[6] At issue is the legal authority of the legislature to permit property tax revenue to be used for purposes other than the purposes authorized by the voters. In the overall scope of local government finances, TIF tax captures can create friction between levels of government when taxes levied for the operation of local school districts, community college districts, parks, libraries, or even county governments are diverted for local economic development purposes. But even within the city, village, or township creating a TIF authority, TIF tax captures have the potential to divert taxes levied for specific (non-economic development) purposes for economic development purposes.

A few issues make TIF tax captures an issue of controversy. First, unlike some other states that authorize tax increment financing, Michigan's authorization of tax increment financing is not limited to those instances where local governments are attempting to remedy blight. Consequently, local governments of all types, fiscal strengths, and needs have adopted one or another of the authorities permitted to use tax increment financing.

[6] See CRC Report #280, February 1986, **Municipal Government Economic Development Incentive Programs in Michigan**, www.crcmich.org/PUBLICAT/1980s/1986/rpt280.pdf

When the Michigan Supreme Court ruled on the constitutionality of LDFAs capturing millage levied for one purpose and diverting it for use in economic development[7] it accepted the premise that "increases in land values and assessments in the project area are caused by the redevelopment authority's own construction of economic activity in the district." (*Advisory Opinion*, 430 Mich. 102)

Because fiscally healthy local governments can create these authorities, the argument that property values increase only because of the reinvestment of tax revenues into the TIF district loses some validity. Fiscally strong local governments may employ these authorities not only to remedy blight, but to further accentuate on the strengths of a business district. In the eyes of overlapping jurisdictions, the creation of these authorities and diversion of funds for economic development purposes removes stable parts of their tax bases without direct benefit to their tax coffers.

Second, the legislature's incremental approach to enacting and amending the General Property Tax act and the laws that enable these authorities have created mixed messages for tax administrators. On the one hand, the laws that enable these authorities say that once a tax increment financing plan is adopted, it is "binding on all taxing units levying ad valorem property taxes or specific local taxes against property located in the authority district."[8] This would appear to be a straightforward indication that certain tax levies were not to be excluded from capture.

Despite this seemingly clear indication of intent, laws enacted or amended at later dates have exempted some taxes from capture. When the six-mill State Education Tax was enacted as part of the 1994 Proposal A school finance reforms, it was excluded from capture unless permission was granted. At the same time, these acts were amended to include a provision to require notice be provided to the governing body of each taxing jurisdiction levying taxes that would be subject to capture if the authority is established and a tax increment financing plan is approved. Then a 2000 amendment to the General Property Tax act was adopted to require that when local governments submit a question to residents of their communities for a tax increase or tax renewal, "the ballot shall fully disclose each local unit of government to which the revenue from that millage will be disbursed."[9]

The conflict between these provisions is self evident. One place in state law says that the TIF districts are to receive revenues from <u>all</u> taxes levied on properties in the districts. In another place the General Property Tax act says that the future capture of taxes has to be disclosed in the ballot questions.

Challenges to tax captures spurred by the Detroit Zoo questioning of the use of their tax revenues and similar questions being asked in other parts of the state may bring to a head this divergence in the provisions in state law. In the end, the applicability of the disclosure provision in the General Property Tax act may be illusory if the provisions of the acts enabling these authorities are upheld. The TIF authorities would be entitled to capture taxes levied on properties within their districts whether doing so was disclosed to the voters or not. However, if the provisions of the General Property Tax act prevail, then it is not clear why any governmental unit would include language to disclose the capture of revenue by TIF districts if doing so results in less revenue in their coffers. This would be especially troubling for countywide authorities or multi-county authorities wherein several TIF districts are in place to benefit from a new tax. (One can imagine the length of a ballot question and the confusion created for the uninformed voters if Oakland County or a county-wide authority in Oakland places a tax question on the ballot listing at least 21 TIF authorities (10 DDAs, 7 TIFAs, and 4 LDFAs as of 2006) to whom revenues from a non-economic development tax are to be disbursed.)

Finally, even within single jurisdictions, where the 2000 amendment to the General Property Tax act would not disclose the diversion of tax revenues for economic

[7] *Advisory Opinion on 1986 PA 281*, 430 Mich 93; 422 NW2d 186 (1988)

[8] LDFA Act, MCL 125.2162(6)

[9] General Property Tax act, MCL 211.24f

development purposes, TIF tax captures will continue to cause accountability troubles for elected officials. The confluence of dedicated tax millages and TIF districts creates disillusion and confusion among voters in the seeming divergence between the tax questions that were approved in municipal elections and financial reports that document how the revenues were actually used.

Over a series of three general purpose elections (2002, 2004, and 2006), counties, cities, villages, and townships in Michigan placed 1,062 requests for tax increases or tax renewals on the ballot.[10] Only 9.4 percent of those requests were for general operations and less than 0.2 percent were specifically for economic development. That means that more than 90 percent of the tax requests at these elections were for specific purposes. To the extent that the jurisdictions requesting these tax increases or renewals had these economic development authorities that were permitted to capture tax revenues through tax increment financing, some of the revenues from these dedicated taxes would instead be diverted for economic development purposes.

Conclusion

For almost 40 years, Michigan local governments have been able to establish special authorities with statutory power to capture tax revenues from taxes levied on certain properties within their jurisdictions. Although Michigan's economy is starting a slow climb out of the doldrums that plagued the state in the 2000s, for most local governments property values will be on a slower growth path. This makes every dollar collected in taxes very dear.

Tax increment financing takes tax revenues from where they were intended when they received voter approval and diverts them for economic development purposes. This practice has caused the governments from whom the revenues are being captured to levy taxes at artificially higher levels to yield sufficient revenues for their own purposes. It also creates a shadow government structure wherein resources are directed for economic development purposes without being subjected to the budgetary scrutiny that other resources and expenditures are put through.

Increased attention to the consequences of tax increment financing could lead to clarity regarding the taxes that are subject to capture and reform of this economic development tool.

[10] See CRC Note 2003-01, **Local Ballot Issues in the 2002 General Election**, March 2003, www.crcmich.org\PUBLICAT\2000s\2003\note0301.pdf; CRC Note 2005-01, **Local Ballot Issues in the 2004 General Election**, February 2005, www.crcmich.org\ PUBLICAT\2000s\ 2005\note0501.pdf; CRC Note 2007-01, **Local Ballot Issues in the 2006 General Election**, April 2007, www.crcmich.org\PUBLICAT\ 2000s\2007\note07-01.pdf.