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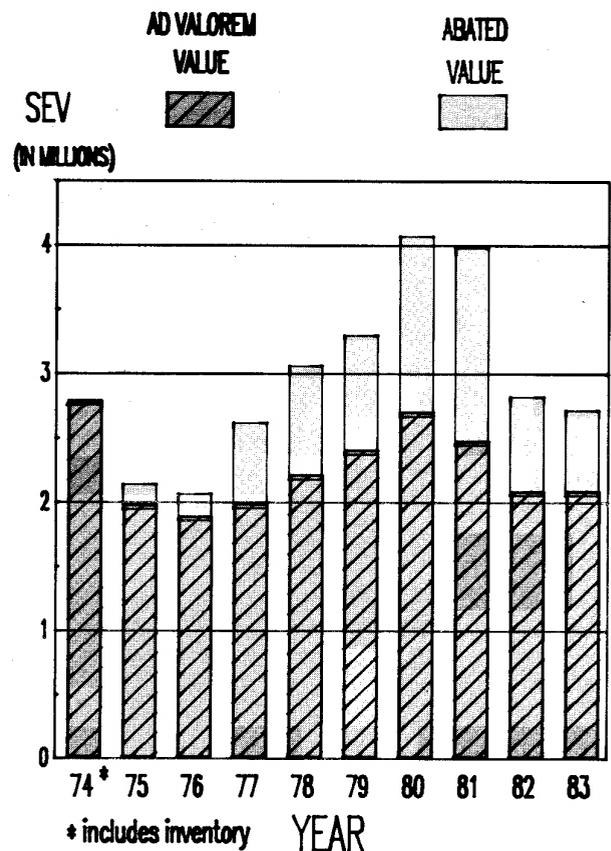
THE USE OF PROPERTY TAX ABATEMENTS IN MICHIGAN, 1974-1983

Cities, villages and townships in Michigan are authorized to grant property tax abatements of at least 50% on selected industrial (P.A. 198 of 1974) and commercial (P.A. 255 of 1978) development occurring within the state. The exact amount of the tax reduction depends on whether the development is considered a new facility or the rehabilitation of an existing facility; however, all abatements are supposed to encourage industrial and commercial development that would not occur without the tax reduction. During the ten-year period 1974-1983, a total of \$7.1 billion of state equalized value was exempted from the general ad valorem, property tax under the industrial property tax abatement program. An additional \$400 million was exempted during the five-year period 1979-1983 under the commercial abatement program. New facilities (taxed at 50% of normal rates) accounted for \$6.2 billion, or 83% of the \$7.5 billion total value abated. Rehabilitated facilities (taxed on pre-rehabilitation values and normal rates, thereby totally exempting all "new" value from taxation) accounted for \$1.3 billion, or 17% of the total value abated. Although 4,408 abatement certificates were issued, relatively few certificates account for a sizable portion of the total value abated.

The table on page 2 shows the total value of all commercial and industrial development occurring in the state since the start of the abatement programs and the portions of that development entering as "new SEV" (fully taxed) and abatements.

The data indicate that a significant amount of the development in the state occurs without a tax abatement. During the period 1974-1983 only 38% of all industrial development received an abatement, and during the period 1979-1983 only 6% of all commercial development received an abatement.

STATE EQUALIZED VALUE OF BUSINESS DEVELOPMENT IN MICHIGAN BY YEAR



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Table 1

STATE EQUALIZED VALUE OF INDUSTRIAL & COMMERCIAL DEVELOPMENT IN MICHIGAN
(in millions)

	<u>New New Real SEV</u>	<u>Personal SEV</u>	<u>Total New SEV</u>	<u>SEV of Abatements</u>	<u>SEV of Total Development</u>	<u>Abatements % of Total Development</u>
INDUSTRIAL, 1974-83	\$5,075.7	\$6,212.6	\$11,288.3	\$6,849.8	\$18,138.1	37.8%
COMMERCIAL, 1979-83	\$3,275.6	\$2,865.3	\$6,141.0	\$400.5	\$6,541.5	6.1%

TAX ABATEMENTS IN LARGE JURISDICTIONS

While all but a few of the 1,777 townships, villages, and cities in Michigan are authorized to grant tax abatements, the data indicate that a small number of municipalities granted the vast majority of abatements. As a result, this analysis focuses on the commercial and industrial abatements granted by the 163 cities and townships with 10,000 or more residents based on the 1980 decennial census. Approximately 76% (\$22.86 billion) of all commercial and industrial ad valorem SEV was located in these jurisdictions on December 31, 1983 (1984 SEV), and these jurisdictions account for almost 82% (\$5.9 billion) of the new value exempted under the tax abatement programs.

Even within this select group of Michigan municipalities, abatements issued in a small number of jurisdictions account for a vast majority of the \$7.25 billion of new value abated in Michigan. In addition, the value of abatements granted by each jurisdiction bears little relationship to the 1984 commercial and industrial ad valorem value in the jurisdiction. For example, the ten jurisdictions exempting the most value account for almost half (48.6%) of the total value abated but accounted for only 22% of the 1984 commercial and industrial SEV in the state. The top twenty-five jurisdictions exempted approximately 70% of all the value abated and accounted for 36.5% of the 1984 ad valorem value.

ECONOMIC DEVELOPMENT, TAX ABATEMENTS, AND TAX RATES

The property tax abatement programs are designed to encourage economic development by providing an incentive to locate a business facility in a particular jurisdiction. The tax reduction incentive is supposed to induce economic development that would not occur in that location absent the incentive. If tax reductions are granted to development that would have occurred without the abatement, the tax break represents a "windfall" rather than an incentive.

From a municipal perspective, judicious use of the abatement programs strictly as an incentive would further the goal of maximizing new tax revenue. A tax abatement granted to a new facility that would not otherwise be built in the community would not only increase the tax base of the municipality (and other taxing jurisdictions such as the school district, county, etc.), but also, hopefully, lead to additional development and the continued growth of the tax base. From a business perspective, the decision to locate a facility in a particular area is based, in part, on the firm's ability to minimize the cost of doing business in that area. One component of business costs is the local tax liability. Therefore, any investment decision would be based, in part, on the ability to minimize the local tax liability.

Contrary to conventional wisdom, the municipal goal of maximizing tax revenue and the business objective of minimizing tax liability are not necessarily in conflict. Both may be attained through a high growth/low tax rate environment. The municipality would maximize tax revenue by generating new revenue from the economic development, and tax liability would be minimized by the imposition of low tax rates. The Research Council examined the relationship between tax rates, tax abatements, and the amount of commercial and industrial growth occurring in the large Michigan municipalities during the period 1976-1983 to determine if the tax policy (tax rates and tax abatements) of local governmental units might influence economic development.

Size of the Business Tax Base. Some areas are unlikely to generate sizable economic development irrespective of the tax policies adopted by the local governmental unit. By definition, the jurisdictions with large commercial and industrial tax bases have been attractive in the past. It is reasonable to expect that tax policy might systematically have affected the continued attractiveness of such areas, whereas tax incentives might not have been capable systematically of overcoming whatever factors have impeded the growth of small-base localities. To better isolate the potential relationship between tax policy and economic development, the analysis was focused on the tax policies of the 82 jurisdictions classified as having a large business tax base.

Use of Abatements. During the eight-year period under consideration, approximately 28% of the commercial and industrial development occurring in the state was subject to an Act 198 or 255 abatement. The 82 large tax base jurisdictions were divided into three groups (high, medium, and low abatement) depending on the amount of abated development that occurred in each jurisdiction. There were 24 high, 15 medium, and 43 low abatement jurisdictions.

Economic Growth. The 82 large business tax base jurisdictions were classified as high, medium, and low growth based on the per capita economic development occurring in each jurisdiction during the eight-year period 1976-1983. There were 41 high, 18 medium, and 23 low growth jurisdictions. The same number (17) of high abatement and low abatement jurisdictions achieved high levels of growth; however, 75% of the high abaters (17 out of 24) and only 40% of the low abaters (17 out of 43) achieved high growth.

Tax Rates. The 82 jurisdictions were separated into high, medium, and low tax categories based on the total tax rate levied in each jurisdiction in 1976 and 1984. There were 24 high tax, 36 medium tax, and 22 low tax jurisdictions.

Since the abatement programs provide tax reductions on selected new development, one might expect a positive relationship to exist between the use of abatements and the overall tax level. That is, high tax jurisdictions should abate more than medium tax jurisdictions, and medium tax jurisdictions should abate more than low tax jurisdictions. The data indicate little relationship, however, between tax rates and use of tax abatements. Although more of the high abatement jurisdictions were high tax than low tax (8 high tax, 4 low tax), the largest number of high abatement jurisdictions (12 out of 24) were classified as medium tax jurisdictions. It is also of interest to note that 13 of the 24 high tax jurisdictions (54.2%), were classified as low abatement jurisdictions.

The distribution of the 82 jurisdictions among the three taxing levels is sufficient to determine if a relationship exists between tax policy and economic growth. Of the 22 low tax jurisdictions, 15 (68%) were high growth jurisdictions, and only 4 (18%) were low growth jurisdictions. Of the 24 high tax jurisdictions, 7 (29%) were high growth jurisdictions and 12 (50%) were low growth jurisdictions (see Table 2 below).

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The data, as shown in the chart to the right, also indicate that per capita ad valorem growth, as well as total (both ad valorem and abated) growth, was almost 50% greater in low tax jurisdictions than in high tax jurisdictions. In the chart, the abated growth has been discounted by 50% to reflect the actual taxable value of all growth.

Do Tax Rates Influence Economic Development? The data in Table 2 also show that an inverse relationship exists between the level of taxation and the use of abatements in the high growth Jurisdictions. Only 4 of the 15 (26.7%) high growth-low tax jurisdictions were high abaters, while 8 of 19 (42.1%) high growth-medium tax and 5 of the 7 (71.4%) high growth-high tax jurisdictions were high abaters.

AVERAGE PER CAPITA GROWTH BY TAX LEVEL IN LARGE BUSINESS TAX BASE JURISDICTIONS

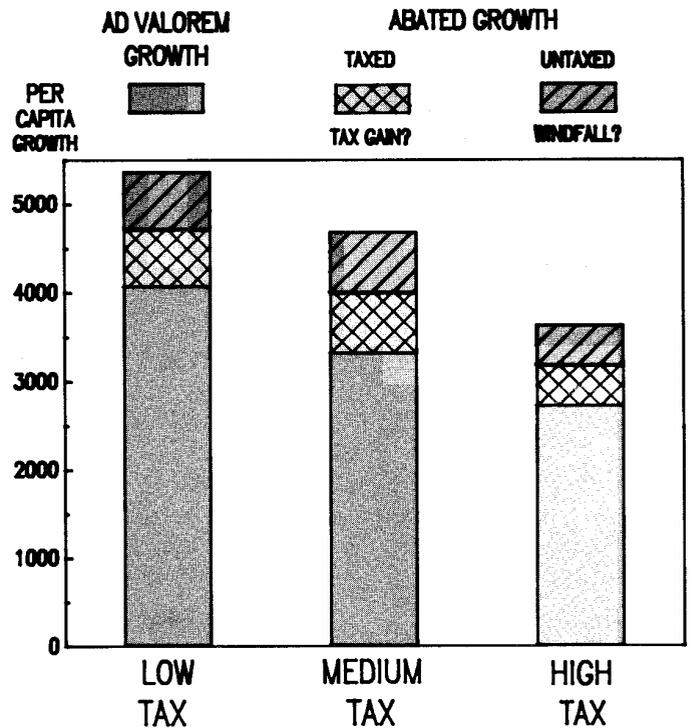


Table 2

RELATIONSHIP BETWEEN TAX RATES AND TAX ABATEMENTS IN HIGH GROWTH JURISDICTIONS

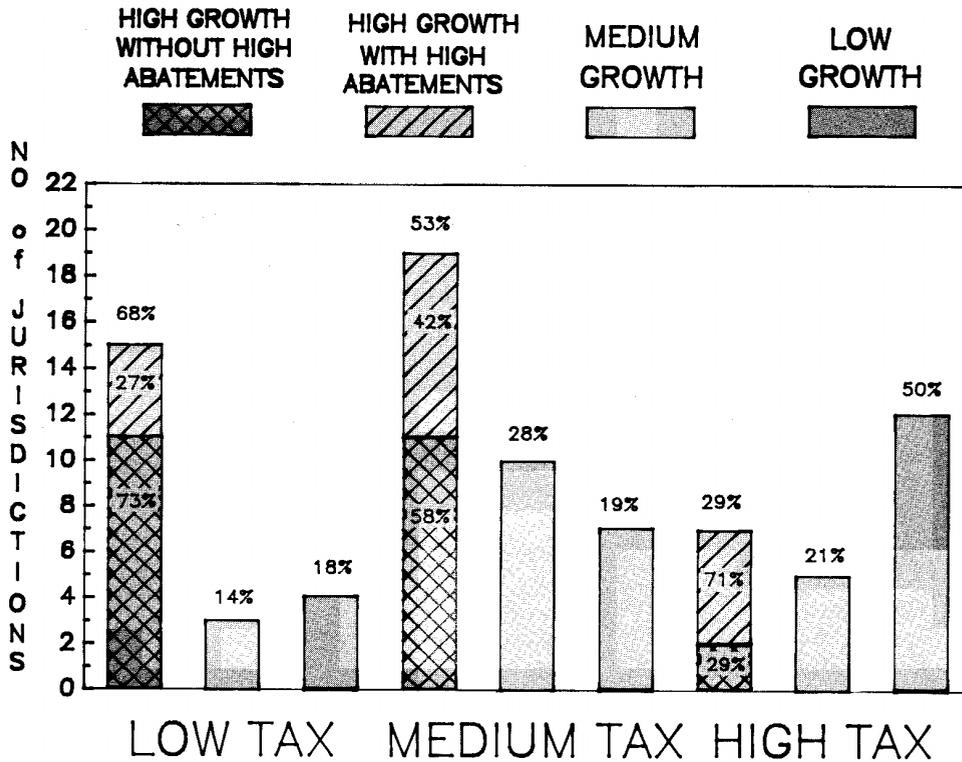
Level of Taxation	No. of Jurisdictions	High Growth	% of Total	High Abatement	% of Growth	of	High
Low Tax	22	15	68.2%	4	26.7%	6	7%
Medium Tax	36	19	52.8%	8	42.1%	2	1%
High Tax	24	7	29.2%	5	71.4%		

As the chart on the next page illustrates, the high tax-high growth jurisdictions appear to have achieved their high growth, in part, by offsetting their high taxes with tax abatements. Low tax-high growth Jurisdictions, on the other hand, appear to be more selective in the use of abatements. It is also of interest to note that 50% of the high tax Jurisdictions experienced low growth, whereas only 18% of the low tax jurisdictions and 19% of the medium tax jurisdictions experienced low growth.

What Comes First: Low Taxes or High Growth?

It is impossible to determine if high growth affords low taxes or low taxes encourage high growth. Two points concerning levels of taxation and high growth, however, are worth noting. First, with minor exceptions, the high growth Jurisdictions that were low tax in 1976 remained low tax in 1984, and the high growth jurisdictions that were high tax in 1976 remained high tax in 1984. Second, aside from a few extremely wealthy jurisdictions, there was very

RELATIONSHIP BETWEEN TAX RATES, TAX ABATEMENTS, AND LEVEL OF GROWTH IN LARGE BUSINESS TAX BASE JURISDICTIONS



little difference among high growth jurisdictions in the total amount of per capita commercial and industrial ad valorem tax base in each of the three tax-level classifications. Thus, at least in these specific instances, it appears that low taxes encouraged high growth, rather than high growth yielding low taxes.

REVENUE IMPACT IN 1984 FROM THE TAX ABATEMENT PROGRAMS

While the abatement programs are designed to encourage economic development, it is impossible to determine if the programs actually encourage development that would not otherwise occur, or provide a windfall by needlessly reducing the ad valorem property tax levy. As a result, the revenue impact of the abatement programs can be estimated, although it is impossible to accurately categorize the fiscal impact as a revenue loss or a revenue gain. In the event that all development granted an abatement occurred solely as a result of the programs, the facilities tax levied on the development would represent a "revenue gain" to the state and local taxing Jurisdictions. On the other hand, if the development would have occurred without the abatement, the tax reductions would represent a "revenue loss" to the state and local taxing Jurisdictions. The direct fiscal im-

part of the abatement programs can, therefore, be viewed as existing along a continuum. At one end of the continuum would be revenue loss and at the other end revenue gain. The real impact of the abatement program would be at some unknown place on the continuum.

The maximum potential revenue loss of the commercial and industrial abatement programs is estimated to be \$155 million in fiscal 1984. The actual revenue loss could be significantly less since this estimate assumes that all new development granted a tax abatement would have occurred without the inducement of a tax abatement. In the event that none of the abated development would have occurred without the tax incentive, the abatement programs actually increased local government revenue. The increased revenue would be the amount of the

facilities tax levied on new industrial facilities and new/replacement commercial facilities. It is estimated that the combined 1984 commercial and industrial facilities tax levy in 1984 was \$135 million.

Revenue Impact by Type of Taxing Jurisdiction. Three types of local governmental units - counties, municipalities (cities, villages, and townships), and school districts - levy virtually all of the local property tax in Michigan. The industrial and commercial facilities taxes (IFT/CFT) are levied by each of these local governments in the same proportion as the ad valorem property tax levy. Any potential revenue loss would also accrue to these units on the same basis. Since the schools are the unit of local government responsible for the vast majority of the property tax levy, they are impacted the most by the abatement programs. The schools account for almost 70% of the ad valorem levy, as contrasted with less than 20% for the cities, villages, and townships authorized to approve abatement certificates. Of the potential "revenue loss," \$99 million would accrue to the schools; \$30 million to cities, villages, and townships; \$18 million to the counties; and, \$4 million to the community colleges.

Since the state school aid formula guarantees that school districts receive equal revenue per pupil for equal local tax effort, any "revenue loss" due to tax abatements granted to commercial and industrial facilities located within an in-formula school district is reimbursed by the state through the basic membership formula. It is estimated that approximately 47% of abated property is located within in-formula districts and 53% is located in out-of-formula districts. As a result, if all of the new development granted a tax abatement would have occurred without the inducement of a tax abatement, the abatement programs cost the state approximately \$46 million in 1985 in reimbursements for value the school districts would have otherwise taxed on an ad valorem basis.

On the other hand, if none of the abated development would have occurred without the tax incentive, the state actually saved \$39 million of state funds it would have spent in school aid payments (the amount of the in-formula school district IFT/CFT levy). In addition, the counties would have received \$15 million; the cities, villages, and townships \$30 million; and, the community colleges \$4 million in new revenue from the facilities tax levies.

CONCLUSIONS

Assessing the success or failure of a particular public policy requires comparing the intended goals or objectives of the policy to the actual achievement. The tax abatement programs were designed to attract business expansion by providing tax breaks to firms that would not otherwise locate or expand their business in Michigan. Since it is impossible to prove or disprove an unknown, the effectiveness of the tax abatement programs cannot be measured with any degree of certainty. While the effectiveness of the tax abatement programs cannot be measured, four major points can be made about the tax abatement programs based on the available data.

1. Despite the size of the abatement programs (4,408 industrial and commercial exemption certificates issued as of December 31, 1983), a significant amount of economic development occurs in Michigan without the benefit of a tax abatement. Of the \$18.1 billion (SEV) in new industrial development that occurred in Michigan during the ten-year period 1974-1983, approximately \$6.9 billion (38%) was subject to an Act 198 tax abatement. Approximately \$400 million (6%) of the \$6.5 billion in new commercial development that occurred during the five-year period 1979-1983 was subject to an Act 255 tax abatement.

2. Since it is impossible to determine the extent to which the tax abatement programs influence investment decisions, it is impossible to determine if the programs represent a revenue gain or loss to governmental units in Michigan. In the event that none of the abated development would have occurred without a tax abatement, the estimated 1984 commercial and industrial facilities tax levy of \$135 million represents a revenue gain to governmental units in Michigan. In the event that all of the abated development would have occurred without an abatement, governmental units in Michigan potentially lost \$155 million in 1984 tax revenue as a result of the tax abatement programs.

3. Those units of government authorized to grant property tax abatements (cities, villages, and townships) account for less than 20% of the property tax levy. When state school aid is taken into consideration, slightly over 50% of the property tax levy is imposed by units of government financially impacted, but having no say in the abatement programs. As noted earlier, however, it is impossible to characterize the impact of the abatement programs on local units of government as a revenue loss or a revenue gain.

4. Relatively few of the 1,777 cities, townships, and villages in Michigan have granted commercial and industrial property tax abatements. The data show that 75 jurisdictions account for over 80% of the total value abated through December 31, 1983, and 16 of these 75 jurisdictions account for over 60% of the total value abated. The data also indicate that a small number of the 4,408 abatement certificates issued account for a significant amount of abated value.

EQUITY CONSIDERATIONS

The selective use of tax abatements to attempt to encourage economic development raises the fundamental issue of equitable tax treatment among industrial and commercial property own-

ers in Michigan. A basic tenet of a “fair” tax system is that the tax laws should be nondiscriminatory. That is, taxpayers in similar circumstances should be taxed in a similar manner. The abatement programs were designed to encourage economic development, and the impression has been that investment only occurs with an abatement. After ten years of industrial abatements and five years of commercial abatements, however, the data indicate that a majority of the economic development in Michigan occurs without the benefit of a tax abatement. Since a small number of certificates issued by relatively few local units of government accounts for a considerable portion of the total value abated, the tax abatement programs give the appearance of inequitable tax treatment among industrial and commercial taxpayers in Michigan.

Article 9, section 3* of the Michigan Constitution requires the legislature to provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law. The Constitution requires uniformity as it relates to tax base, as well as to tax rate. The Constitution permits the legislature to provide for alternative means of taxation of designated real and tangible personal property in lieu of general ad valorem taxation. Thus, the legislature permitted the exemption of selected new industrial and commercial property from general ad valorem property taxation and subjected the exempted property to a specific facilities tax, in lieu of the general ad valorem property tax.

The Michigan Supreme Court has stated that there are two types of taxes — ad valorem and specific. Any tax that is based upon value is an ad valorem tax and any tax that is based upon a standard other than value (i.e. weight, count, etc.) is a specific tax. In **Pingree v. Auditor General**, the Court said “a tax based upon the assessed cash value of the property assessed is not a specific tax. It is an ad valorem tax,

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and any enactment by a legislature that it is a specific tax does not make it so.”

Although both P.A. 198 and P.A. 255 authorize specific taxes, the facilities tax levied on new industrial property and new/replacement commercial property is based on the value of the facility, and the value is determined in exactly the same manner as for the general ad valorem property tax. Further, these facilities taxes are levied at a rate that is exactly one-half of the ad valorem rate in the local taxing Jurisdiction. Consequently, it would appear the facilities tax is an ad valorem tax and any tax rate that is different than the tax rate levied on all other real and tangible personal property in the taxing jurisdiction would violate the uniformity requirements of the Michigan Constitution. The Michigan courts, however, have never ruled on the constitutionality of the facilities taxes.

Although it is not possible to determine the true impact of the tax abatement programs on busi-

ness investment decisions, the data seem to indicate that in those communities experiencing high business tax base growth during the past eight years, low tax rates were more important than the use of property tax abatements. Consequently, a low tax environment for all taxpayers, rather than low taxes for selected taxpayers, might be a better strategy for long-term economic development in Michigan.

All citizens of Michigan ultimately benefit from a high level of economic development; therefore the continued encouragement of long-term economic development is a desirable objective. The current tax abatement programs, however, not only create the appearance of an inequitable property tax system without adequate justification for the inequality, but also raise serious constitutional issues. Providing tax incentives to all new investment occurring in the state might be a more appropriate method of encouraging economic development.