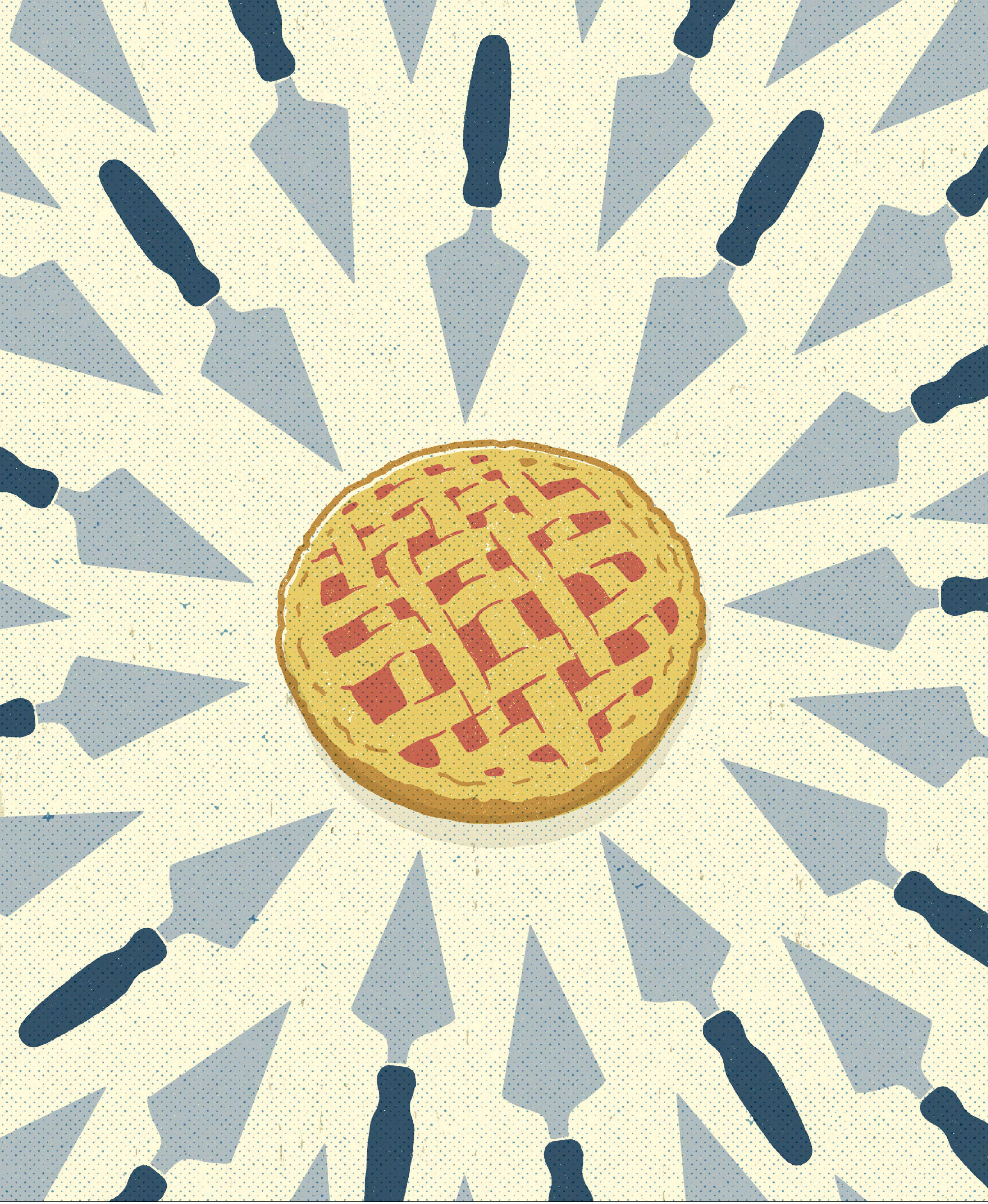


Taking Another Look at **Tax-Base Sharing**

BY PAUL GILJE

July 2021 will mark the 50th anniversary of pioneering legislation in Minnesota to address fiscal implications of metropolitanism. The law—which adjusts for differences among municipalities in the commercial/industrial (C/I) property tax base without sacrificing local control, increasing taxes, or moving functions to higher levels of government—continues to attract interest across the nation. Similar actions are rare, however, and none is as far-reaching as Minnesota's.

The law pools 40 percent of net growth since 1971 in the C/I property tax base among some 190 municipalities in the Minneapolis-St. Paul metro area. The pooled valuations are immediately redistributed back to the 190 municipalities, according to population modified inversely by tax wealth. Among municipalities with populations of more than 9,000, the wealthiest municipality without the law in 2020 would have 13 times the per capita C/I base as the poorest, or 13 to 1. With the law, the ratio is 6 to 1.

Everyone contributes and everyone receives. Higher-valuation municipalities still end up with the highest per capita C/I valuation, but less than they would have had without the law. Lower valuation municipalities still end up with less, but more than they otherwise would have had.

EFFECT ON REVENUE

Tax-base sharing affects the *capacity* of a municipality to raise revenue, but it raises no revenue by itself. What happens is that property tax burdens shift somewhat from slower-growing, moderately priced bedroom communities to wealthier, more rapidly growing municipalities with more commercial-industrial tax base.

Without tax-base sharing, among metro-area cities with populations of more than 10,000 in 2018, the six largest recipient cities would have seen their homestead taxes go up between 11 percent and 22 percent, according to the Minnesota House of Representatives Research Department.[1] Among the six largest contributor-cities, homestead taxes would have decreased between 2.6 percent and 4.4 percent.

There is less to the impact of the law than meets the eye. Some municipalities receive about as much as they put in. The total C/I value shared in 2020 is $477 million, which is not insubstantial. But every municipality or township receives back some of what it contributed. Only a fraction actually gets taken from the "losers" and ends up in the hands of the "winners." About 29 percent of the $477 million gets transferred to the winners; about 71 percent is returned to the municipalities and townships from which it was contributed.

Tax-base sharing eases the strain on municipalities that, because of their location—not near major transportation facilities such as airports, freeways and freeway interchanges, and transit and transit stations—are unable to attract major shopping centers, office parks, or industrial buildings. The law also keeps municipalities from being unduly penalized by refraining to develop land that should remain as open space.

Before tax-base sharing was enacted, municipalities openly embraced "fiscal zoning," by which they discouraged new development that didn't "pay its own way in property taxes." Municipalities still encourage more expensive homes, but they now recognize—or should recognize—that all new residents, whether renters or owners, in apartments or single-family residences, in lower-priced or higher-priced residences, bring a share of C/I tax base with them. This is because the pool is apportioned based on population, modified somewhat by whether a city is above- or below-average in tax-base wealth. It seems that municipalities are more open to accepting lower-priced housing today than before tax-base sharing was enacted.

In December 2020, the Center for Policy Design (CPD) published a free online book on the half-century history of tax-base sharing, *How Could You Do This?*[2] (See sidebar for more information.) Walter McClure, founder and chair of the board of directors of CPD, says in a foreword: "Systems and organizations tend to behave the way they're structured and rewarded to behave. If you don't like the way they're behaving, you probably ought to change the way they're structured and rewarded."

TIF DISTRICTS

Opponents had predicted that municipalities would no longer encourage C/I development, but this never came to pass. In fact, considering the widespread use of tax-increment financing (TIF) and other tools, municipalities appear every bit as development-oriented today as they ever were.

Property tax revenue in TIF districts is diverted to pay expenses of the districts and doesn't flow into the treasury of local operating budgets until after TIF bonds are paid off. Municipalities can't use TIF to escape contributions to tax-base sharing. Nevertheless, TIF remains highly popular with municipalities. For the year ended December 31, 2018, 408 units of government in the State of Minnesota had 1,651 tax-increment districts that produced $230 million in TIF revenue, according to the Minnesota State Auditor.[3] It makes no difference whether municipalities are small, medium or large; rich or poor in tax base or income; central city, developed suburb or developing suburb; rural or urban. All types use TIF. Today, in fact, it's commonplace for developers to approach a city with plans that expect or assume that TIF will be used.

State auditors' data indicate that municipalities exhibit no reluctance to welcome and invest tax dollars in stimulating new development, which clearly indicates that tax-base sharing has not reduced municipalities' interest in attracting development within their borders.

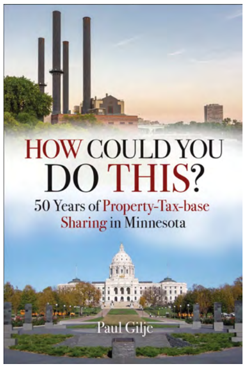
Except for an exemption granted in 2013 to the City of Bloomington, Minnesota for the Mall of America, C/I growth in TIF districts must be included in a municipality's tax-base sharing contribution. If a TIF district is allowed to keep all of the property value and tax revenue, the municipality must contribute a higher percentage of its C/I value outside the TIF district to the tax-base sharing pool to make up for the non-contributing value in the TIF district. Or the municipality may provide the contributed portion if the TIF district is not available as tax increment to the district.

ORIGINS OF THE CONCEPT

The concept of tax-base sharing originated with the Citizens League, a nonpartisan citizens organization in the Minneapolis-St. Paul metro area. In 1968-69, a committee of volunteers in the open-membership organization reviewed the consequences of wide differences in property tax base among municipalities in the metro area. The committee was well aware of strong views about respecting the authority and independence of these municipalities and an opposition to higher levels of government taking over functions. Further, other strong forces in the Minnesota Legislature were averse to increasing areawide taxes or giving new taxing authority to local governments. Consequently, more recognizable but less appealing or realistic ideas—such as consolidation, moving functions to a higher level, and state aid—were passed over.

The citizens committee came to understand the perverse incentives that side-by-side municipalities follow to enrich their own property tax revenue capacity, by zoning and other controls, irrespective of the impact on their neighbors. By virtue of outside factors such as location of transportation facilities or land condition, some municipalities will always be winners, and some will always be losers.

The committee began exploring whether these incentives could be modified so that municipalities acting in their own best interests would also benefit the region as a whole. The committee realized that future development is at stake. This wasn't an issue of disrupting what already has occurred—no locality needed to lose what it already had. No one knew absolutely where future growth would occur.



How Could You Do This?
By Paul Gilje

In December 2020, the nonprofit Center for Policy Design (CPD) published a book on the half-century history of tax-base sharing.

For a free online version of the book, please visit gfoa.org/Gilje-book.

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WALTER MCCLURE, FOUNDER AND CHAIR OF THE BOARD OF DIRECTORS OF CENTER FOR POLICY DESIGN

The committee rallied around an idea advanced by one of its citizen-members, who sat on a suburban school board, that future growth in C/I tax base could be shared throughout the metro area. Figuratively and legally, independent of where located physically, a portion of future C/I growth in taxable value could be distributed among all metro area municipalities as part of their own tax base. That member, F. Warren Preeshl, stressed that municipalities would continue to make their own budgetary decisions as in the past. As had been the case with C/I property in the past, a municipality would not be able to "raid" any part of the shared tax base. It would have to impose the same tax rate on its own resident-citizens.

A legal challenge in the Minnesota Supreme Court was overturned in 1982. Tax-base sharing was enacted by the Minnesota Legislature for municipalities on Minnesota's Iron Range in 1996. This law, too, was ultimately upheld by the Supreme Court in 2002.

OTHER TAKES

The impact of tax-base sharing in other areas appears to have stimulated them to look to their own traditions rather than trying to enact something similar to Minnesota's.

The City of Cleveland, Ohio

A bill for voluntary tax-base-sharing was introduced in the Ohio Legislature in May 2020. The bill would allow municipalities in the greater Cleveland area to form regional economic development alliances.

"Regional Economic Development Alliances would be an additional tool through which municipalities could coordinate economic development activities, share services and collaborate to implement cost-efficiency measures," the sponsors of the bill said. "What is distinct about the REDAs is the permissibility of alliance members to create a revenue gain-sharing program, through which pooled financial resources could be used to advance alliance purposes."[4]

The City of Pittsburgh, Pennsylvania

Three Pennsylvania suburbs—Munhall, Homestead, and West Homestead—share 270 acres along the Monongahela River that was originally property of U.S. Steel Homestead Works but has been redeveloped as the Waterfront shopping mall. The three communities have created a tax increment finance district for the area. Ultimately, when the TIF bonds have been paid, the three suburbs are scheduled to share property tax revenue from the entire project.

Pittsburgh and other municipalities in Allegheny County share in one-fourth of a countywide one percent sales tax, with each city's share based on need.[5]

New Jersey Meadowlands

A 14-city tax-base sharing arrangement for an 18,000-acre site across the river from New York City was enacted in 1972 as a location for a major league ballpark and other developments. For a history of the Meadowlands development, see *New Jersey Meadowlands: A History*.[6] As of mid-2020, Meadowlands remains the closest enacted example of tax-base sharing outside Minnesota.

The City of Detroit, Michigan

In his 1976 State of the State address, the governor proposed tax-base sharing for Detroit and its suburbs.[7] The proposal died, possibly because differences in city-suburb tax-base wealth made it look like too much of a bailout of the central city. In 1985, a bill was introduced in the Michigan House of Representatives to allow local governments to enter into tax-sharing agreements, but it never made it out of committee.

The City of Sacramento, California

A 2002 proposal in Sacramento involved sharing some sales tax revenue among the six counties and 21 municipalities that make up the Sacramento metropolitan area. "Regional tax sharing is becoming a controversial issue in California as the Assembly prepares this month to debate Assemblyman Darrell Steinberg's AB 680, which would share some of the sales tax growth in the Sacramento region ... Imagine if the economic development directors of each of the 100 boxes in the region stopped fighting with each other, stopped sprawling against each other, and actually found incentives to work together. Imagine how the local economy and quality of life might improve. Tax-base sharing can be a major first step in that direction."[8] Steinberg's bill passed the Assembly but died in the Senate.

The City of Des Moines, Iowa

Richard S. Davis, executive director of the Polk-Des Moines Taxpayers Association, suggested tax-base sharing for Polk County, Des Moines, and other counties, in a 1984 newspaper article.[9] "It can reduce competition for new development by providing a means for communities to benefit from growth anywhere in the region," Davis wrote. "It assures additional valuation growth for municipalities lacking land for expansion. Since the majority of valuation remains with the city in which the development occurs, municipalities still have an incentive to promote commercial and industrial location within their borders. And, taxpayers in central municipalities can receive relief from a disproportionately high tax burden resulting from a declining population and valuation base."

The idea was endorsed by the Joint Economic Development Committee, made up of members of the Des Moines City Council, Polk County Board of Supervisors, suburban mayors, and businesspeople.[10] A bill was introduced in the Iowa Legislature, but no further action occurred.[11]

The City of Allentown, Pennsylvania

In 1999, the Lehigh Valley Partnership, a consortium of business officials, released a study by the Pennsylvania Economy League outlining the benefits of tax-base sharing.[12] "Among the expected benefits would be the stunting of urban sprawl, increased revenue for municipalities in need, and the revitalization and consistent growth of the three largest municipalities: Allentown, Bethlehem and Eaton."

The proposal was modified to provide for a one percent sales tax among Lehigh Valley counties and their municipalities, with the revenue to be shared among local governments on largely the same basis as Minnesota's property-tax-base sharing. Ultimately the proposal was defeated in controversy over which units of local government would be included.

Government Finance Officers Association (GFOA)

GFOA represents more than 20,000 members who are federal, state/provincial, and local finance officials in United States and Canadian governments. In a current report, GFOA notes that some 90,000 units of local governments in the United States in 2017 cumulatively spent about $1.9 trillion.[13] The report emphasizes tax-base sharing because it addresses "one of the most important disadvantages of local government fragmentation," the differences in taxable fiscal resources among municipalities, school districts, and counties, usually encapsulated as "fiscal disparities." The report goes on to describe the Minnesota tax-base sharing law, "one of the most comprehensive and enduring solutions to fiscal disparities," adding, "There does not, however, appear to be any more recent attempts to create something similar."

Less comprehensive strategies, GFOA suggests, would include (a) state revenue sharing, in which revenues are collected at the state level and distributed to localities "proportionally or progressively relative to taxpayers' income or wealth", and (b) changing incentives that local governments offer to encourage new development, but that "are not often effective in achieving their goals" and "often simply cause firms to move within the region."

The Lincoln Institute of Land Policy

The Lincoln Institute, which had conducted a much earlier study of tax-base sharing,[14] was considering a study in summer 2020 that would examine whether communities that are net recipients of tax-base sharing are in better fiscal health because of the program, and the contributors in tax-base sharing are not fiscally worse off because of the program, according to Jenna DeAngelo, associate director. To undertake such a study, DeAngelo said in an email, the Lincoln Institute would need access to comparable financial documents for municipalities both before and after tax-base sharing was implemented.

CONCLUSION

Nothing with tax-base sharing urgently needs change: 50 years without legislative modification of its major provisions is a strong indicator of the ongoing reliability of the balance struck in 1971. Moreover, tax-base sharing functions automatically, year after year, without requiring annual legislative reauthorization. This helps local governments make development and fiscal plans accordingly.

Should other states consider tax-base sharing? Sure. Other metro areas aren't unlike the Twin Cities area in governmental fragmentation, inevitable differences in tax base, and beggar-thy-neighbor approaches to zoning. It's valuable to know what others are doing. But instead of trying to enact another's solution, perhaps it is more desirable and realistic to seek consensus on the nature of the problems and then move to evaluating solutions, which should include a variety of possibilities, including tax-base sharing.

__Paul Gilje__ is a senior fellow at the Center for Policy Design.

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3 "Tax Increment Financing Legislative Report," Office of the State Auditor, March 5, 2020.
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