SHARING OF TAX GROWTH – REDEFINITIONS

Under Minnesota's metropolitan tax-base sharing act, units of government have access to the property tax resources of the entire region of which they are a part without imposing some new regional tax or abrogating the independent decision-making authority of these local units

By Paul A. Gilje

IMAGINE PAUL BUNYAN strolling out of the northern Minnesota woods into the Minneapolis-St. Paul metropolitan area. He takes out a giant pair of scissors and snips a few floors off every skyscraper, a few buildings out of every industrial park and a few stores out of every shopping center. Then he rearranges the pieces throughout the metropolitan area, so that every city and suburb gets a share.

This is happening legally—albeit not physically—for purposes of property taxation under Minnesota's metropolitan tax-base sharing act (Minn. Stat. 473F).

Passed in 1971 and found constitutional in 1974, the act now is entering its fourth year of implementation and is producing precisely the results which were intended.

In 1978, close to one-tenth of the total value of commercial-industrial property in the seven-county Minneapolis-St. Paul metropolitan area is being shared. Under our classification-assessment system this is about $200 million in assessed value, which is almost $500 million in actual market value.

Under the law, a percentage of the assessed value of all municipalities and townships (about 200 of them) in the metropolitan area is removed from the localities and placed in a regional pool. Each municipality and township then is reassigned a proportionate share of that pooled valuation according to a formula which considers population and market value per capita. The redistributed tax base then becomes subject to taxation along with the remaining property which was not pooled.

The amount placed in the regional pool is equal to 40 percent of the net growth in commercial-industrial valuation in each locality since 1971. The result is that the entire metropolitan area is sharing *legally* in 40 percent of the net growth of commercial-industrial valuation, irrespective of where in the area the growth occurs *physically*.

TAX BASE DIFFERENCES ARE NARROWING; FISCAL ZONING INCENTIVES ARE LESSENING. As intended, the act is reducing—partially and gradually—the wide differences in commercial-industrial valuation per capita among cities and suburbs in our metropolitan area.

Among municipalities with population in excess of 9,000, the range in commercial-industrial per capita was from a low of $341 to a high of $2,091, in 1975. If the law were not in effect, the range would have been from a low of $230 to a high of $2,368. In coming years, as more and more commercial-industrial valuation is shared, the range will continue to narrow.

Localities experiencing the greatest amount of new development in commercial-industrial properties within their borders are not growing in assessed valuation quite as fast as they would without the law. Tax rates in these localities, therefore, are a little bit higher than they otherwise would be.

Localities which are growing very slowly or even declining in valuation are receiving more valuation because of the base-sharing law, which makes their tax rates a little lower than they otherwise would be.

Without the law, the suburb of Shakopee would have gained $1,629 in commercial-industrial valuation per capita from 1971 to 1975. But because of sharing, its net gain was reduced to $1,013 per capita (which still was a larger gain than any other municipality over 9,000 in population, even before sharing).

At the other end of the scale, the suburb of South St. Paul would have experienced a net loss of $86 per capita in commercial-industrial valuation from 1971 to 1975. But because of the sharing, South St. Paul ended with a slight gain, $23 per capita.

As differences in tax *base* narrow, differences in tax *rates* among localities will narrow, too, assuming comparable levels of government spending would prevail with or without the sharing.

No comprehensive analysis of tax rates has been made yet. Many factors affect the tax rates. Moreover, actual changes in tax rates to date as a result of base sharing alone would be small because the total amount of base shared is still a very small portion of the total valuation of the region.

However, a frequently overlooked aspect of tax-base sharing produces another impact on narrowing tax rates, which already is becoming quite significant for some commercial-industrial properties. A uniform areawide mill rate is derived in the base-sharing process. The areawide mill rate is a weighted average of all the local mill rates and is applied in each locality on the valuation of commercial-industrial property which is shared.

If the local mill rate in such a locality is lower than the areawide mill rate, such as in some upper-income suburbs, then commercial-industrial properties in that community are paying higher taxes. If the local mill rate is higher, such as in the central cities, then commercial-industrial properties there are paying lower taxes.

Another impact of the law is the moderate effect it seems to be having on development decisions within localities. In the six years since the law was passed, localities have not reduced the amount of land zoned for commercial-industrial development. They continue to welcome new shopping centers, office complexes and industrial parks. For example, Minneapolis and Eden Prairie recently engaged in spirited competition for a new research headquarters for the Pillsbury Company. Minneapolis won. The law was designed to reduce, not eliminate, fiscal competition in the metropolitan area. Any locality knows that it still will receive 60 percent of the growth of new commercial-industrial valuation exclusively for itself.

Municipalities no longer seem as "desperate" for tax base as they formerly were. Some municipalities formerly would permit only housing over a certain minimum value, because housing below that value would not pay its own taxes. We don't hear that any more, at least partially because the formula for redistribution of the pooled commercial-industrial valuation is based on population.

Because all municipalites now share in the commercial-industrial tax base wherever it occurs in the region, we might expect they would undertake more cooperative activities to encourage new development, rather than seeming to continue to compete with each other. Perhaps the full implications of tax-base sharing are not yet realized. Perhaps, too, there are more significant reasons for intermunicipal competition within a metropolitan area, such as, for example, location of jobs or developers' desires to make a profit on their land.

Redistributing a portion of the metropolitan commercial-industrial tax base needs to be seen in the larger context of Minnesota's policy towards local government over the last 10 years. During this time the legislature has moved to impose higher sales and income taxes and redistribute the revenues to local governments. With the exception of Deluth, which had its local sales tax grandfathered in, local governments are prohibited from levying local sales and income taxes. You might say we have full sharing statewide of the local sales and income tax base and a partial sharing in the metropolitan area of the local property tax base.

TAX-BASE SHARING IS DISTINCTLY DIFFERENT FROM TAX SHARING. It may be helpful to keep in mind that tax-base sharing takes place in advance of the time that units of government levy taxes on the shared and nonshared portions of the tax base.

Each unit of government's taxable valuation is determined by (1) adding all valuation physically located within the locality, (2) subtracting the amount required to be contributed to the regional pool and (3) adding the amount received from the regional pool.

As was noted earlier in the article, the amount contributed to the pool is equal to 40 percent of the net growth in commercial-industrial valuation in that locality since 1971. This means that increases in valuation because of new construction and inflation and decreases in valuation because of demolitions and reductions in value are counted in determining net growth.

Each parcel of commercial-industrial valuation in the locality shares proportionately in the contribution, irrespective of whether the parcel itself has increased or decreased in value since 1971. The proportion contributed is equal to the percentage which the shared growth bears to the total commercial-industrial valuation in the locality.

Every municipality is assigned a share of the regional pool according to a formula based on population, but with a locality's share adjusted up or down depending upon whether its total per capita valuation is below or above the metropolitan average per capita.

Once the contributions and distributions of the areawide tax base have been accomplished, each local unit of government has available a dollar

> **The law doesn't solve the revenue problems of local government. That it could solve such problems is perhaps the biggest myth of all**

valuation. The valuation is made up of two parts: the local base which is not shared and the locality's share of the areawide tax base.

In Minnesota almost all mill rates are derived by dividing the dollars of tax levy by the valuation. In some states, the mill rate may be set in law. Minnesota also has a few such rates for special purposes. Either way, once the mill rate is determined, it is applied to the valuation.

The local mill rate is applied to each parcel of property which is not shared, including that portion of commercial-industrial valuation which remains local.

The local mill rate also is multiplied by the municipality's share of the areawide pool. The result is a dollar figure in taxes which represents the amount which the municipality is, in effect, taxing the regional pool. Such dollar amounts are added together for all taxing units in the seven-county metropolitan area. The total is divided by the valuation in the areawide tax base. The result is an areawide mill rate, which is then applied throughout the metropolitan area on the portion of each parcel of commercial-industrial valuation which is shared.

The tax bill sent to the residential property owner is unchanged. The tax bill to the commercial-industrial owner looks different. The local mill rate is applied to the portion of the value which remains local, and the areawide mill rate is applied to the portion which is contributed to the areawide pool. As noted earlier, taxes on commercial-industrial valuation are becoming more similar, regardless of the physical location of the valuation in the metropolitan area.

CERTAIN ASPECTS OF TAX-BASE SHARING ARE MISUNDERSTOOD. Because tax-base sharing is new and represents a significant departure from more conventional thinking about the property tax, it frequently is misunderstood.

The idea of moving tax base *legally* even though not *physically* is hard to grasp. Most of us are inclined to think that a building constructed in one community must be in that community for tax purposes. Not necessarily, according to the tax-base sharing law. The law demonstrates that a municipality's tax base is a legal construct, a mathematical figure derived from the application of state laws. The legislature declares that some property is tax-exempt. It may declare that certain property must be assessed at a higher level than others. Tax-base sharing is another adjustment. Think of the law as lifting 40 percent of the net growth in commercial-industrial valuation in the metropolitan area off the ground, flattening it out and dropping it back down again.

People sometimes think that the law applies to certain kinds of local governments and not to others. It applies to all local taxing units in our metropolitan area, cities and townships, school districts, counties and special taxing districts.

It is almost misleading to say that the law applies to a unit of government. We like to say it applies to locations around the regions, assessment districts, if you will. The law shifts valuation among these assessment districts. Whatever units of government happen to overlie the locations then take whatever valuation happens to occur where they are located, for purposes of taxation. The tax *base* is rearranged, therefore, before any of the overlapping taxing units impose any *taxes* on the rearranged tax base.

PAUL A. GILJE is currently Associate Director of the Citizens League, a private, public affairs association in Minneapolis. He has staffed several Citizens League studies on tax and finance, including the report, "Breaking the Tyranny of the Local Property Tax," March 1969, which contained the tax-base sharing proposal refered to in this article. Previously he was a staff writer for the Minneapolis Star.

As we mentioned earlier, each municipality and township receives a share of the areawide tax base. Any unit of government which covers only a part of the municipality or township must be assigned a share of the areawide tax base attributed to that locality. The law provides that the distribution within the municipality is to be based on residential valuation. So if a watershed district within a municipality has 10 percent of the residential valuation of that municipality, it will receive 10 percent of the areawide tax base assigned from the pool to that municipality.

Sometimes the provision for sharing 40 percent of the net growth is thought to apply only to new construction. This is inaccurate. The law provides that 40 percent of the net growth of commercial-industrial valuation is shared, irrespective of how that growth has occured, including but not limited to new construction. The total commercial-industrial valuation in the current year is compared to the total in the base year, which was 1971. If there is no net growth, or if there is a decline, the municipality contributes nothing. Declines in valuation can offset increases due to new construction or inflation. In effect, the law shares the benefit of growth and the burden of decline.

Contrary to some impressions, each unit of government receives the revenue from the taxes it levies. It does not have to levy fewer dollars if it is a "winner" or more dollars if it is a "loser" in the contributions-distributions calculations. Each unit of government continues to levy taxes exactly as it would in the absence of the base sharing law. A unit of government will receive the taxes it levies and not need to pay attention to whether the revenue it receives comes from taxes on its share of the areawide tax base or from taxes on its local tax base.

Everyone contributes; everyone shares. Every locality with any commercial-industrial growth at all must make its 40 percent contribution to the regional pool. And everyone receives a share in return, even the wealthiest localities in the region. The formula does give a smaller share to the localities with higher-than-average total valuation per capita and a larger share to localities below average. But everyone receives something.

The impact of the law must be seen over a period of years, not just this year or next. A locality which is contributing now may be on the receiving end in the future.

It may help to think of the law as an insurance policy. Everyone pays the premium: 40 percent of net growth in commercial-industrial valuation. Everyone receives some benefit: a proportionate share of the region's growth wherever it happens to occur. Rather than gamble that growth will occur sufficiently in your locality, you can give up some of your anticipated growth in return for a guarantee of receiving a share of the region's.

The law is not just a plan to save the central cities at the expense of the suburbs. As a matter of fact, our two central cities, Minneapolis and St. Paul, currently are gaining significantly under the law. Minneapolis receives about 20 percent of the pool and St. Paul, about 16 percent, with the suburbs sharing the remaining 64 percent.

In 1978 Minneapolis will receive about $40 million in valuation from the pool after contributing less than half-a-million-dollar's worth. St. Paul will be receiving about $32 million and contributing about $3 million.

The law treats the central cities just as it treats the suburbs. If they grow in coming years, they will have to share. In both central cities, in fact, some persons have felt that maybe they ought to gamble on a go-it-alone approach. Minneapolis, for example, was required to share the growth brought about by one of the largest office towers west of the Mississippi, the 57-story IDS Tower. But the growth attributed to that building, about $40 million in assessed value, has been almost entirely offset by demolitions and devaluations elsewhere in the city. As a result, the growth which the city of Minneapolis has experienced in commercial-industrial valuation since 1971 is almost solely due to the tax-base sharing law.

The law doesn't solve the revenue problems of local government. That it could solve such problems perhaps is the biggest myth of all. Tax-base sharing itself raises no money. It affects the capacity of units of government to raise taxes, but they themselves must take the step, knowing that the rate of taxation applied against the areawide tax base will fall on their own voters/taxpayers, too. Tax-base sharing is not a new source of revenue. It is a way to make an existing revenue source more workable in a metropolitan area with so many taxing districts side-by-side. In another sense, the net play-out is in tax rates, to taxpayers.

TAX-BASE DIFFERENCES, CREATION OF THE METROPOLITAN COUNCIL, AND A POWER PLANT CONTROVERSY STIMULATED PASSAGE OF THE LAW. In the latter half of the 1960s, wide differences were present in property taxes on comparably priced homes throughout the metropolitan area. Some of the localities with the lowest tax rates had the highest level of services; some with the highest tax rates had the lowest level of services. These "disparities" became more widely known as the daily newspapers began publishing regularly the results of surveys comparing property taxes among localities.

In 1967, the legislature created the Metropolitan Council, a one-person, one-vote government covering the entire seven-county area. The council was given limited authority over metropolitan special purpose districts. A legislator representing some northern suburbs, Rep. Charles Weaver, sensed that in coming years the Metropolitan Council might begin to influence land use in the metropolitan area. He was fearful that the council's land use policies might stimulate growth in other parts of the region with no tax benefit going to certain localities, including his own, with more limited commercial-industrial growth potential.

Perhaps one of the most hotly debated land use decisions in the metropolitan area in the mid-1960s was the construction of a new power plant on the St. Croix River. Legislators and other public officials from Washington County, where the power plant was located, were criticized for stimulating the development of the power plant along what was on its way to becoming a "wild and scenic" river. Legislators from that area angrily replied they wouldn't mind preserving open space for the entire metropolitan area if they could have in return a share of the tax base growth elsewhere in the region.

It was in this setting that a committee of the Citizens League began discussion in 1968 of the problem "fiscal disparities." The league is a private public affairs association, with some 3,000 members in the metropolitan area. The league describes its objectives as helping the community understand its problems and what to do about them.

The league committee debated many options to correct for fiscal disparities. One option was to merge units of government in the metropolitan area. Not a bad idea, some people said, but it was wholly unrealistic for our region. Any such resulting unit of government would be too big to be effective in operations or responsive to the electorate. Another option was to tax all commercial-industrial property in the metropolitan area at one rate and distribute the money back to localities by formula. This, too, would alleviate disparities, but it also would place a great deal of power in the body that would decide the rate of taxation and the formula for distribution of revenues. A less ambitious suggestion was simply that the legislature levy a uniform tax on all property in the metropolitan area and distribute the revenue back to local governments by formula. Nice, neat and simple, but threatening.

None of these options appealed to Warren Preeshl, a member of the Citizens League committee who himself at that time was a suburban school board member and a municipal bond consultant. Preeshl wanted to give local governments access to the region's wealth without setting up a new taxing structure at the metropolitan level and without disrupting local decision-making authority. He modestly advanced the tax-base sharing concept one evening when the committee was struggling with the pros and cons of other approaches. Actually, he had written out his idea about six months earlier but didn't bother to tell anyone. After considerable debate and some close votes Preeshl's idea was adopted by the Citizens League committee. The committee's report was approved by the Citizens League Board of Directors and made public in March, 1969.

A Fiscal Disparities subcommittee headed by Rep. Weaver had already been meeting in the legislature and was anxiously looking for a workable plan. Weaver instructed the House staff to draft a bill along the lines of the Citizens League proposal. Although introduced with only about a month remaining in the session, the bill passed the House in 1969. Time ran out before the Senate could consider the bill. During the interim between the 1969 and 1971 sessions, the Metropolitan Council conducted a major study of the region's revenue needs. The council endorsed tax-base sharing as part of its 1971 legislative program. This time Weaver's bill passed both the House and the Senate and promptly was signed by the Governor. Governor Wendell Anderson's major proposals for reform of state school aid and municipal aid formulas also were adopted in 1971, making the session one of the most significant in state-local fiscal relationships in the state's history.

Before the tax-base sharing law could be implemented, it was challenged in court by Burnsville, a suburb which expected to be a loser under the law. Burnsville's challenge was successful in District Court but was overturned by the Minnesota Supreme Court, 4-3, in September, 1974.

"The fiscal disparities statute is a bold and imaginative departure from conventional devices for balancing the benefits and burdens of taxation," wrote Justice James Otis for a majority of the Court. "As we have suggested, we are quick to concede that a strict application of our prior decisions would require us to lean strongly for affirmance (of the District Court decision). The trial court cannot be faulted for reading those decisions as it did. Nevertheless, we are today dealing with a viable, fluid, transient society where traditional concepts of what confers a tax benefit may be too parochial."

The Minnesota Supreme Court also noted that the Rodriguez decision of the U.S. Supreme Court challenges states to develop solutions of their own to the problems of maldistribution of tax resources. State legislators, not the Supreme Court must find solutions to the fiscal disparities problems that have plagued the states, the Rodriguez decision said.

The tax-base sharing law became effective for taxes payable in 1975. County officials worked hard in the fall of 1974 to begin the first year's implementation. A minor change was made by the legislature in 1976 to make the administration of the law easier.

Having survived legislative, judicial and administrative challenges, the tax-base sharing law now has become an accepted part of the fiscal system in our metropolitan area.

Perhaps one of the stronger indications of its acceptance are the results of a survey of elected, administrative, and planning officials in 50 municipalities in the seven-county metropolitan area, conducted by Rex Honey, assistant professor, Department of Geography, University of Iowa, and Robert H. Ericksen, research associate, Institute for Urban and Regional Research, University of Iowa. Fifteen of the municipalities contributed more to the pool than they received back in 1975. The other 35 received more than they contributed.

In response to a question whether the law is a desirable tool which other metropolitan areas would be wise to adopt, Honey and Ericksen reported a majority of the losers said yes, even though their own municipalities were losing, at least in the short-run. An overwhelming majority of gainers answered yes, they reported.

Tax-base sharing moves slowly, not rapidly. This can be an asset because its effects are gradual and can be planned over time

TAX-BASE SHARING ISSUES, POSSIBLE CHANGES, CONTINUE TO BE DISCUSSED. One suggestion is that an ability-to-pay provision should be introduced on the contribution side as well as the distribution side. Now, a low-valuation locality may be fortunate enough to get some growth in commercial-industrial development but is required to contribute to the regional pool on the same basis as the more wealthy communities.

From time to time others have suggested that 40 percent of all commercial-industrial valuation—not just the growth since 1971—should be placed in the pool. This would eliminate special benefits to high valuation localities which may have experienced most of their growth before 1971. Such a move would make commercial-industrial property taxes throughout the metropolitan area much more uniform than today, because 40 percent of all commercial-industrial valuation then would be bearing the areawide mill rate.

On occasion the idea is advanced that the sharing percentage ought to be raised above 40 percent. Such an idea usually comes from communities likely to gain the most.

The possibility of applying the tax-base sharing concept to other problems of tax equity has come up specifically in connection with high-valuation power plants in rural areas. Would it be possible, some persons have asked, to apply tax-base sharing as a way to give all units of government a share in the growth brought about by new power plants?

The relationship between tax-base sharing and tax-increment financing probably has been the most vexing for the Minnesota Legislature. The truth is that the concepts can operate fully side by side without problems. Tax-increment financing is a device for using the increase in taxes brought about by redevelopment to finance the governmental share of redevelopment expense.

Because of the language of the Minnesota tax-increment financing law, an artificial limitation is placed on the amount of increment that can be pledged to pay for redevelopment expenses in localities where tax-base sharing is in effect. The present law is being interpreted as prohibiting more than 60 percent of the growth in taxes in a tax increment district to be pledged to pay the expenses of redevelopment, on the assumption that the remaining 40 percent has to go into the tax-base sharing pool. That is *not* required...and has been introduced only through a misunderstanding about tax *base* sharing as against *tax* sharing. It is quite possible to assure that a municipality makes a full contribution of 40 percent of its net growth in commercial-industrial valuation, including the growth attributed to the tax-increment district, and still provide that the revenues from the tax-increment district can be pledged in full to pay the redevelopment expenses.

THE CONCEPT OF TAX-BASE SHARING HAS APPLICABILITY ELSEWHERE. Hardly a week goes by that we don't receive requests to send information to states or metropolitan areas across the country. As far as we can determine, no other state has yet adopted a tax-base sharing law. The idea has been under most serious consideration in Virginia, Maryland, Michigan, California, and Alberta, Canada.

We are not familiar with the administration of the property tax in other states. Perhaps the Minnesota law is not directly transferable. It is the principle of the law which makes it particularly attractive: to give units of government access to the tax resources of the entire region of which they are a part without imposing some new regional tax or abrogating the independent decision-making authority of these local units.

Tax-base sharing may not be the best or most urgent improvement for every area. In our metropolitan area, no unit of government receives more than 20 percent of the regional pool. In a metropolitan area where one locality received as much as 50 percent of the pool, the situation might be different.

Another metropolitan area might find redistribution of state school aids or state municipal aids as higher priority. Tax-base sharing, as noted earlier, does not raise revenue.

Tax-base sharing moves slowly, not rapidly. This is an asset because its effects are gradual and can be planned over time. This also can be a liability, because you can't move a great deal of tax resources quickly into a locality requiring immediate help.

A particular advantage of tax-base sharing is that it works automatically. The growth continues to be shared, and the size of the pool continues to increase, year by year, without the need for additional legislation.

The most compelling reason for tax-base sharing is that it accomplishes some homogenization of the property tax base in a metropolitan area in the least threatening fashion possible. It removes no authority from local governments. They continue to operate exactly as they have in the past. It does not involve the creation of some sort of metropolitan taxing unit which would make a political decision each year about the rate to be levied on business property and on the formula for distribution. Under the Minnesota plan, an areawide tax rate is *derived* arithmetically from the amounts each unit of government decides to levy for its own local purposes.

These are the points which seem so important as we look to the long term. Local government is likely to remain strong in our metropolitan areas. Radical attempts to place all units under one big revenue-raising umbrella are not likely to succeed, nor are such approaches necessarily desirable anyway. Commercial-industrial development will continue to be concentrated in some parts on our metropolitan areas and not others. Unnecessary competition and bad feeling among different parts of each metropolitan area is likely to result.

Tax-base sharing helps reduce the likelihood of such attitudes without disrupting traditional autonomy and authority of local governments and contributes to a feeling of regional identification which, while not overriding, is, nevertheless, still important. □

For additional information contact: Metropolitan Council, 330 Metro Square Building, St. Paul, Minn. 55101; Commissioner of Revenue, Centennial Building, St. Paul, Minn. 55155; Administrative Auditor, Base-Sharing Law, County Auditor, Court House, Anoka, Minn. 55303, and Citizens League, 530 Syndicate Building, Minneapolis, Minn. 55402.