Citizens League
84 S. 6th St., Room 530
Minneapolis, MN 55402

October 31, 1985

STATEMENT TO HOUSE TAX SUBCOMMITTEE ON FISCAL DISPARITIES

1. Minnesota should retain the metropolitan tax-base sharing law.

a. Law functioning as intended.--The law is reducing, partially and gradually, differences in commercial-industrial taxable valuation in the metropolitan area. This was the intent of the legislation when adopted in 1971. Were the law not in effect, the wealthiest city in commercial-industrial tax base per capita would have 15 times as much as the poorest city. With the law in effect, the wealthiest has four times as much as the poorest. Of course, the existing law never will eliminate differences. Assuming no change in law, differences will not narrow beyond about three to one.

Differences in tax rates on all property are less with the law than without it. In addition, differences in tax rates on commercial-industrial property are narrowed even further. The reason is that a uniform metropolitan tax rate applies to the shared portion of commercial-industrial valuation.

b. The law requires no legislative appropriation.--Unlike other ways to help finance local governments, the law requires no state aid, which means it does not impose a burden on the state general revenue fund.

Tax-base sharing often is thought of as a source of revenue for local governments. But the revenue does not come automatically. A city, for example, can levy taxes on its share of the regional pool of valuations. But it receives no money unless it actually levies the taxes, with the knowledge that the same tax rate also will fall on its resident voters.

c. Tax-base sharing grows automatically, year-by-year, without additional legislative action.--The Legislature doesn't have to re-authorize metropolitan tax-base sharing every biennium, in stark contrast to its time-consuming biennial (sometimes annual) struggles with state aid to schools, cities and counties and property tax relief.

2. The same objectives cannot be accomplished through other state aid programs.--In theory, state aids could compensate for differences in tax base so that net burdens on taxpayers would be no more or less without the law than with it. Practically speaking, it would be impossible.

a. <u>All units of government would be affected.</u>--Because the gain or loss in tax base affects all overlapping taxing jurisdictions (cities, schools, counties, and special taxing districts), the adjustment in aids to compensate for tax-base differences would be extremely complicated.

b. <u>Changes would be required every biennium.</u>--Even if "perfect" adjustments in state aids were possible, it would be necessary for the Legislature to re-enact such legislation every year, to further adjust for inevitable changes in tax base in coming years. A look at the Legislature's difficulty in maintaining equalization of school aids should illustrate the practical impossibility of expecting that the Legislature could replicate through state aids the redistribution now accomplished by metropolitan tax-base sharing.

c. <u>A statewide approach would be almost inevitable.</u>--The Legislature could not be expected to make an appropriation for the Twin Cities metropolitan area without a comparable investment in the rest of the state. That would double the ante of state aids.

3. <u>But the Legislature should improve the law.</u>--The fact that the Legislature has made so few changes since the law was found constitutional 11 years ago is testimony to its essential strength. Nevertheless, some changes should be made:

a. <u>Phase out exemptions</u>--When the law was passed, the Legislature exempted certain properties: (a) property in tax-increment districts, (b) cities with a special designation from the federal Economic Development Administration, and (c) property at Minneapolis-St. Paul International Airport.

Since passage the Legislature has acted twice to reduce the size of the tax-increment exemption, in 1974 and in 1979. The Legislature in 1986 should complete this job by phasing out the remaining properties covered by this exemption. The phase-out can be accomplished without affecting the flow of revenues to any tax-increment district, simply by requiring that each city make the required contribution from other properties within its borders.

Contrary to some critics of the law, the Legislature has not granted any exemptions since the law was passed. It has only acted to cut back on exemptions granted at the time of passage in 1971. Thus recent proposals to grant exemptions to specific properties are without precedent.

South Saint Paul, with the EDA designation, is the only city in the metropolitan area that has made no contribution to the metropolitan tax-base sharing pool yet has received an annual distribution from the pool from everyone else. Federal funds available through EDA have been trimmed considerably. The designation, no longer significant, apparently remains until withdrawn by the EDA.

Property at the main airport (not the satellite airports) is subject to taxation by the Metropolitan Airports Commission (in effect, the municipal levy), Hennepin County and metropolitan agencies. However, it is exempt from taxation by school districts and is exempt from making a contribution to the regional pool of valuations. Property at the main airport probably is more "regional" in its character than any other property in the metropolitan area. It should make the same contribution to the regional pool as all other commercial-industrial valuations.

b. Disallow erosion of the regional pool by other exemptions--The Legislature is being asked in 1985 to grant an exemption from the tax-base sharing law to help finance a megamall at the old Metropolitan Stadium site in Bloomington. As we noted in an earlier statement this year, the Legislature can provide the same dollars and be fairer to all parties involved through a direct tax that falls in the same proportion on all taxpayers.

c. Remove cities that don't allow commercial-industrial development in their borders from sharing in the metropolitan tax-base sharing pool.--Cities that refuse to accept commercial-industrial development within their borders should not expect to share in the regional pool. Denying them a right to share would remove a common source of criticism of tax-base sharing. The issue is almst entirely symbolic, however, because cities that don't allow commercial-industrial development are so small that their shares of the regional pool are insignificant.

d. Don't allow communities to escape making contributions by undervaluing property.--Currently, cities make contributions to the pool based on assessed valuation. Thus, if property is undervalued, the amount contributed is less than if property were correctly valued. Of course, a city that undervalues property to escape making a tax-base sharing contribution also has less local value available to tax.

The Legislature should adjust the amounts contributed to tax-base sharing largely just as it adjusts school aids and municipal aids. Moreover, distributions from tax-base sharing are made on the basis of equalized valuation, so it makes common sense to adjust contributions accordingly.

The adjustment should be phased in over time, to avoid large swings in any one year.

A major obstacle to accomplishing this objective might be the difficulty in obtaining legislative agreement on the best figures to use in making the adjustment. Sometimes so few commercial-industrial sales occur in one city during a year that an accurate "sales ratio" for commercial-industrial property cannot be obtained. One possibility is to use the residential ratio for all properties instead.

e. Consider a variable contribution rate based on wealth of each city--We are intrigued by a preliminary idea from the chair of the House Tax Committee that the contribution rate--now 40 percent for all cities, irrespective of wealth--vary based on whether a city is above or below average in commercial-industrial tax base per capita. Thus, for example, an above-average city might make a higher contribution and a below-average city, a lower contribution. A variable contribution rate should be adopted only if the result is a greater reduction in differences in commercial-industrial valuation than is accomplished now.

f. Consider a phase-in of sharing pre-1971 commercial-industrial value.--Under current law cities are required to share growth since January 1, 1971. Cities that have experienced most of their growth since 1971 are heavier contributors than others. As years go by, the importance of this "grandfather" diminishes, because the pre-1971 valuation becomes a smaller and smaller proportion of total value. Yet public confidence in the integrity of tax-base sharing is impaired by any exemption. About 90 percent of the pre-1971 value is concentrated in 10 cities, most of which already are major contributors to the regional pool. It would be possible, however, to phase in the pre-1971 value over a long period of time, say 10 to 20 years, so that its impact would hardly be felt.

4. Certain provisions should not be changed.

a. Don't share residential value--An essential part of the integrity of tax-base sharing is that residential value remain local. When city councils, school boards and county boards decide their spending levels for the following year, they now can tell their local resident/voters what the property tax rate will be on their homes. That is the key factor in maintaining accountability for property tax increases. Local governing boards may want to impose higher taxes on non-residential property but they know they can't do so unless the same rate falls on residential property.

If residential value were subject to tax-base sharing, city councils and other local governing boards no longer could tell their local resident/voters what the tax burden will be. Instead, the tax burden would be based on what every other unit of government decided to levy. The result might well be that everyone would impose higher taxes, to be assured of their "fair share". Or the Legislature would remove all local discretion over the property tax and set the rate centrally.

b. Don't provide for a "floating" base year--Some persons are suggesting that the base year should move forward, so that only so many years are subject to sharing. The effect of a "floating" base would be to share property only for a few years and then return it to the exclusive use of the units of government where the property is located. Such action is totally contrary to the concept of tax-base sharing. Its effect would be to give more tax base to high valuation communities and less to the low valuation communities. What public policy is served by such action?