

American Planning Association Growing Smart Project, Model Tax Increment Financing Statute

Commentary: Tax Increment Financing

BASICS^{1[1]}

Tax increment financing, or “TIF,” is a method of financing redevelopment activities that is directly tied to the success of those activities. With some exceptions, an economically depressed area of a local government brings in much less tax revenue than an economically healthy area of equivalent size and population. If such an area can be made attractive to developers, and tax-generating private development occurs where it has not in recent years, then the tax revenue collected from the area should rise. Tax increment financing taps into this increase in tax revenue to finance the improvements and activities that make redevelopment occur.

Essentially, the local government determines the property tax revenue it is collecting in the given area before redevelopment occurs. The local government then borrows money, with loans or by the sale of bonds. The borrowed funds are used in various ways to improve the development prospects of the area: loans to new businesses, capital improvements, new services such as improved street cleaning and security patrols, advertising and marketing. As development occurs in the area, tax revenue increases, and the excess above pre-redevelopment property tax revenue in the area is used to pay off the loans or bonds and to finance further redevelopment activities. That excess is the “tax increment” in tax increment financing.

TIF ISSUES

Tax increment financing sounds very attractive -- the local government is (theoretically) not giving up any revenue, as the tax increment would not (again, theoretically) exist were it not for the redevelopment activities financed by that increment. However, there are potential problems with TIF.

If tax increment financing is imposed where it is not needed to encourage development -- where development would have occurred in the absence of TIF -- then the tax increment does not represent (or only a portion represents) local government revenues that would not have otherwise been collected. Instead, the tax increment cuts into general revenue that the local government would have otherwise received.

^{1[1]} A good introduction to tax increment financing is Sam Casella, Tschangho John Kim, Clyde W. Forrest, and Karen A. Przypyszny, *Tax Increment Financing* Planning Advisory Service Report No. 389 (Chicago: Amer. Planning Ass’n, 1985). See also Donald G. Haman and Julian C. Juergensmeyer, *Urban Planning and Land Development Control Law*, 2nd Ed. (St. Paul, Minn.: West, 1986), 551-553; Jonathan Davidson, “Tax-Related Development Strategies for Local Government,” in J. Benjamin Gailey, ed., *1985 Zoning and Planning Law Handbook*, (New York: Clark Boardman Co., 1985) 234-241; Christina G. Dudley, “Tax Increment Financing for Redevelopment in Missouri: Beauty and the Beast,” *U. Mo. K.C. L. Rev.* 54. (1985): 77; Jonathan M. Davidson, “Tax Increment Financing as a Tool for Community Development,” *U. Det. J. Urb. L.* 56 (1979): 405.

This is especially problematic when the tax increment consists not only of the “additional” property tax revenue otherwise payable to the local government but of a general cap at pre-TIF levels on property valuations or tax assessments. If tax increment financing is structured in this manner, and is imposed when not necessary, the tax increment also deprives other governmental bodies that receive property tax revenue -- school districts, other special districts, the county, and so forth -- of the increase they would otherwise have received.

LEGAL CHALLENGES TO TIF

Statutes authorizing tax increment finance have been challenged in the courts on a variety of theories. The most broadly-applicable grounds -- basic constitutional arguments of due process and equal protection -- have also been the least successful. Since the property tax assessed and collected from the landowner remains the same, property in the TIF district is not being classified separately from land outside the district for purposes of equal protection and uniform taxation clauses.^{2[2]} Courts have rejected claims by taxpayers outside a TIF district that the shifting of tax revenues under tax increment financing causes them to bear a burden for which they receive no benefit.^{3[3]} The allocation of TIF money to private development has been upheld against legal challenge when the private benefits were incidental to the implementation of a redevelopment plan that served a valid public purpose.^{4[4]} Allegations that TIF constitutes a taking have also been unsuccessful,^{5[5]} as have claims that the allocation of TIF revenue to a religiously-affiliated entity in the redevelopment area constituted a violation of the establishment of religion clause of the First Amendment (and its state-constitution equivalents).^{6[6]}

On the other hand, specific provisions in state constitutions have been the basis for successful challenges to TIF statutes and ordinances on some occasions. Several states impose debt limits on local governments, and while some courts have found that bonds financed with tax increments do not apply to the debt limit, on the grounds that the increment would not exist in the absence of TIF,^{7[7]} other courts have found that a local government exceeded its limits by issuing TIF-secured bonds.^{8[8]} Similarly, some courts have struck down TIF ordinances that included a bond issue on the basis that the issuance of any local government bonds secured by *ad valorem* taxes must be approved by

^{2[2]} *State ex rel. Schneider v. City of Topeka*, 605 P.2d 556 (Kan. 1980); *Metropolitan Dev. & Housing Agency v. Leech*, 591 S.W.2d 427 (Tenn. 1979).

^{3[3]} *South Bend Pub. Trans. Corp. v. City of South Bend*, 428 N.E.2d 217 (Ind. 1981).

^{4[4]} *Meierhenry v. City of Huron*, 354 N.W.2d 171 (S.D. 1984); *Short v. City of Minneapolis*, 269 N.W.2d 331 (Minn. 1978); *Tribe v. Salt Lake City Corp.*, 540 P.2d 499 (Utah 1975).

^{5[5]} *Metropolitan Dev. & Housing Agency v. Leech*, 591 S.W.2d 427 (Tenn. 1979); *Richards v. City of Muscatine*, 237 N.W.2d 48 (Iowa 1975).

^{6[6]} *In re Minneapolis Community Dev. Agency*, 439 N.W.2d 708 (Minn. 1989), cert. den'd 493 U.S. 894 (1989).

^{7[7]} *State v. Miami Beach Redev. Agency*, 392 So.2d 875 (Fla. 1980); *Denver Urban Renewal Auth. v. Byrne*, 618 P.2d 1374 (Colo. 1980).

^{8[8]} *Richards v. City of Muscatine*, 237 N.W.2d 48 (Iowa 1975).

referendum.^{9[9]} Other state courts, where only measures that would increase taxes or the tax obligation require approval by the voters, rejected this argument.^{10[10]} Another effective basis for legal attacks on TIF has been specific constitutional provisions that school taxes could be spent only for the support of public schools; the tax increment on the portion of property taxes intended to fund public schools was deemed an improper diversion of educational funding to non-educational purposes.^{11[11]}

STATE TIF STATUTES

Nearly every state has adopted statutes authorizing tax increment financing programs to raise funds for redevelopment.^{12[12]}

California pioneered tax increment financing and is one of the leading users of TIF. Under its statute,^{13[13]} TIF may be imposed only where it “shall be necessary for effective redevelopment.” TIF-eligible redevelopment areas must be blighted, though it is expressly provided that not all property or buildings in the area need be in a blighted condition so long as “such conditions predominate.” Redevelopment areas need not be contiguous. TIF may be applied specifically to promote affordable housing in non-blighted areas by financing a Low- and Moderate-Income Housing Fund. A redevelopment plan for the TIF area must be adopted, and it must contain a time limit, which for the exercise of eminent domain can be no more than 12 years from the plan’s adoption.

The local government may issue bonds or obligations secured by revenue from the TIF, from the affected or other redevelopment projects, from general local government taxes, or from state and federal assistance funds. The TIF revenue must be deposited into a separate account for the redevelopment area. At least 20 percent of the increment revenue must be spent on low- and moderate-income housing for displaced residents unless housing needs in the local government are already met.

Illinois’ Tax Increment Allocation Redevelopment Act^{14[14]} was the model for the TIF statutes in **Missouri**^{15[15]} and South **Carolina**.^{16[16]} The area must be found to be “blighted” (several factors constituting blight are defined) or to constitute a “conservation area” (areas with at least half the housing over 35 years old that are not blighted but may become blighted due to certain enumerated factors) to qualify for tax increment financing. Redevelopment areas

^{9[9]} *City of Tucson v. Corbin*, 623 P.2d 1239 (Ariz. Ct. App. 1980); *Miller v. Covington Dev. Auth.*, 539 S.W.2d 1 (Ky. 1975). But see *Metropolitan Dev. & Housing Agency v. Leech*, 591 S.W.2d 427 (Tenn. 1979).

^{10[10]} *Tax Increment Fin. Comm’n of Kansas City v. J.E. Dunn Constr. Co.*, 781 S.W.2d 70 (Mo. 1989).

^{11[11]} *Miller v. Covington Dev. Auth.*, 539 S.W.2d 1 (Ky. 1976).

^{12[12]} Alan C. Weinstein & Maxine Goodman Levin, “Tax Increment Financing,” Chapter 33B in Patrick J. Rohan & Eric D. Kelly, eds., *Zoning and Land Use Control*, Vol. 6 (New York: Matthew Bender & Co. 1998).

^{13[13]} Cal. Health & Safety Code §§33000 *et seq.*

^{14[14]} 65 Ill. Comp. Stat. §§5/11-74.4-1 *et seq.*

^{15[15]} Mo. Rev. Stat. §§99-800 *et seq.*

^{16[16]} S.C. Code §§31-6-10 *et seq.*

must consist of contiguous properties. A redevelopment plan must be adopted for the area before it is created, and the plan must be consistent with the comprehensive plan and found to be necessary to the development of the area. There must be notice -- to the public, property owners and residents of the area, and affected taxing units -- and a hearing before the redevelopment area can be declared and tax increment financing imposed. The redevelopment area cannot be in effect more than 23 years, and no bond or obligation to finance redevelopment can last longer than the redevelopment area.

The property tax increment itself is derived as follows: The property tax assessments of all the land in the redevelopment area at the time of the adoption of the TIF ordinance are added together. The property tax rates of the various taxing units are then applied to that figure rather than to the present assessed value of the properties, and the sums derived are paid to the taxing units as in the absence of TIF. What is left over from the application of the tax rates to the present assessed values once that sum is paid goes into a special account to cover redevelopment costs and/or debt service on bonds issued to pay redevelopment costs. Under the Illinois statute, local sales taxes may also be subjects of tax increment financing.

To finance redevelopment, the local government may issue bonds and other obligations, secured not only by TIF revenue, but also by general tax revenue, revenues from redevelopment activities, mortgages on redevelopment property, or even the full faith and credit of the local government.

Minnesota, along with California as mentioned above, is one of the leading states in employing tax increment financing. Its statute^{17[17]} provides that TIF may be applied in certain “redevelopment districts” and “housing districts” as defined by certain criteria, and in catch-all, less-stringent “economic development districts.” To exclude farmland and undeveloped land from TIF districts, TIF areas cannot include vacant land unless that land meets very specific and narrow criteria. Redevelopment and housing districts may have a duration of 25 years, while economic development districts can last no more than the shorter of 10 years from the adoption of the tax increment financing plan or 8 years from the receipt of the first tax increment. A tax increment financing plan must be adopted for the TIF district after notice and a hearing, and it must specify the redevelopment tools and activities it will be financing. The entire tax increment may be applied to redevelopment costs and debt service pursuant to the TIF plan.

Ohio’s statute^{18[18]} addresses the issue of property taxes assessed on behalf of other governmental units. School districts that are affected by a TIF district must be notified of its creation. The school board must approve the TIF, or a payment in lieu of taxes must be made to the school district, if it will exist more

^{17[17]} Minn. Stat. §§469.174 *et seq.*

^{18[18]} Ohio Rev. Code §§5709.40 *et seq.* (municipalities), §§5709.73 *et seq.* (townships), and §§5709.77 *et seq.* (counties).

than ten years or affect more than a certain percentage of the assessed valuation. Agreements exempting a portion of the tax increment (that is, paying part of the tax increase to the school district) may also be entered into by the local government and the school district. [Other states have also addressed this issue. **New York**^{19[19]} and **Florida**^{20[20]} exempt school districts from the application of tax increment financing. **Kentucky**^{21[21]} allows taxing units to exempt themselves -- a taxing unit must agree with the local government for its tax revenue to be subject to the tax increment.]

More generally, the Ohio TIF statutes provide that a tax increment financing district must be created by ordinance. The ordinance must include a fixed term for the district, not to exceed thirty years, and must be filed with the state Department of Development. The local government must also file annual status reports with the Department for the duration of the TIF district.

CONTENTS OF THE MODEL STATUTE

One of the central features of Section 14-302 below is that tax increment financing is intrinsically linked to the broader redevelopment program it is intended to finance. A TIF ordinance cannot be adopted unless there is a redevelopment area plan in place and an ordinance to implement that plan has been adopted. As with all other land development regulations, a TIF ordinance must be consistent with the development area plan. In this manner, TIF is coordinated with the broader efforts to redevelop a “depressed” or underdeveloped area. Unlike the TIF statutes of some states, this model does not describe how TIF money is to be spent; this is determined by the redevelopment area plan and the redevelopment area ordinance implementing it.

Another important element of the Section, derived from several of the existing state statutes, is that tax increment financing must be found to be essential; that is, without TIF, the redevelopment area plan could not be implemented. As discussed above, tax increment financing is a special tool to be used only where necessary. On the other hand, redevelopment activity is generally desirable and encouraged, and the *Guidebook* generally does not apply a necessity test to the adoption of a redevelopment area plan or ordinance. Therefore, the necessity requirement has been placed in brackets so that it is optional: each adopting legislature may include or remove it.

There are several places in the text where “on behalf of the local government” is in brackets. This is alternative language, creating two different approaches to property tax increments. With the bracketed phrase omitted, the tax increment represents all new or additional property tax revenue in the redevelopment area, whether collected on behalf of the local government or some other taxing entity (school districts, for instance). When the bracketed language is included, only the additional property tax revenue collected for the

^{19[19]} N.Y. Gen. Mun. Law §970-n.

^{20[20]} Fla. Stat. §163.340(2).

^{21[21]} Ky. Rev. Stat. §§99.751(8), 99.761.

local government is included in the tax increment, eliminating claims that TIF is cutting into the tax revenues of other government bodies.

The Section authorizes local governments, at their option, to impose tax increment financing on local sales taxes. Unlike real property taxes, it is typical for local governments to collect their own sales taxes. Therefore, TIF applies under the Section only to the local government's own sales taxes; there is no alternative language as with the real property tax increment.

The model statute provides for the deposit of the tax increment revenue in a special account and for the distribution of any funds remaining in that account when redevelopment activities terminate. Since the total tax increment represents revenue that was collected pursuant to the regular real property and/or sales taxes but was set aside for a special purpose -- redevelopment -- when that special purpose terminates, those funds should go where tax revenue normally goes. If the tax increment applies only to the property and sales tax assessed on behalf of the local government, the leftover money goes into the local government's general fund. If the tax increment represents the additional property and sales taxes that would have gone to all taxing units, the funds are distributed to the taxing units *pro rata*. Unused sales tax increment go back to the local government, since the increment is upon only the local government's sales tax.

14-302 Tax Increment Financing

- (1) A local government may adopt and amend in the manner for land development regulations pursuant to Section [8-103 *or cite to some other provisions, such as a municipal charter or state statute governing the adoption of ordinance*] a tax increment finance ordinance pursuant to this Section.
- (2) The purposes of tax increment financing are to:
 - (a) finance the redevelopment of duly-established redevelopment areas;
 - (b) raise funds for such redevelopment without unduly burdening the public at large; and
 - (c) account for the costs and benefits of such funding in a manner transparent to the public.
- (3) As used in this Section, and in any other Section where "tax increment financing" is referred to:
 - (a) **"Base Individual Property Tax"** means the real property tax assessed [on behalf of the local government] on an individual lot or parcel in the redevelopment area at the

last assessment of real property taxes before the adoption of the tax increment finance ordinance;

- (b) **“Base Sales Tax”** means the taxes levied by, and collected by or on behalf of, the local government pursuant to [*cite sales tax statutes*] on transactions at places of business located within the redevelopment area for the [6] months preceding the calendar month in which the tax increment finance ordinance becomes effective;
- (c) **“Individual Property Tax Increment”** means the difference between the base individual property tax and the present individual property tax;
- (d) **“Present Individual Property Tax”** means the real property tax assessed [on behalf of the local government] on an individual lot or parcel in the redevelopment area at the most recent assessment of real property taxes;
- (e) **“Present Sales Tax”** means the taxes levied by, and collected by or on behalf of, the local government pursuant to [*cite sales tax statutes*] on transactions at places of business located within the redevelopment area for every [6] month period, commencing with the calendar month directly following the month in which the tax increment finance ordinance becomes effective;
- (f) **“Sales Tax Increment”** means the difference between the base sales tax and the present sales tax;
- (g) **“Total Base Property Tax”** means the real property tax assessed [on behalf of the local government] on all lots or parcels in the redevelopment area at the most recent assessment of real property taxes;
- (h) **“Total Present Property Tax”** means the real property tax assessed [on behalf of the local government] on all lots or parcels in the redevelopment area at the most recent assessment of real property taxes;
- (i) **“Total Property Tax Increment”** means the difference between the total base property tax and the total present property tax; and
- (j) **“Total Tax Increment”** means the sum of the total property tax increment and the sales tax increment.

- The total property tax increment should also constitute the sum of all individual property tax increments in the redevelopment area.

- (4) Tax increment finance may be established only pursuant to a tax increment finance ordinance adopted pursuant to this Section.
- (a) A tax increment finance ordinance shall not be adopted unless the local government has adopted:
1. a local comprehensive plan with a redevelopment area plan pursuant to Section [7-302]; and
 2. a redevelopment area ordinance pursuant to Section [14-301].
- [(b) A tax increment finance ordinance shall not be adopted unless:
1. redevelopment would not occur in the redevelopment area without employing redevelopment assistance tools as described in the redevelopment area plan; and
 2. the redevelopment area plan could not be implemented without tax increment financing.]
- (5) A tax increment finance ordinance pursuant to this Section shall include the following minimum provisions:
- (a) a citation to enabling authority to adopt and amend the ordinance;
- (b) a statement of purpose consistent with the purposes of land development regulations pursuant to Section [8-103] and the purposes of this Section;
- (c) a statement of consistency with the local comprehensive plan, and with the redevelopment area plan in particular, that is based on findings pursuant to Section [8-104];
- (d) definitions, as appropriate, for such words or terms contained in the ordinance. Where this Act defines words or terms, the ordinance shall incorporate those definitions, either directly or by reference;
- [(e) specific findings, pursuant to the redevelopment area plan, supporting that:
1. redevelopment would not occur in the redevelopment area without employing redevelopment assistance tools as described in the redevelopment area plan; and
 2. the redevelopment area plan could not be implemented without tax increment financing;]

- (f) a description, both in words and with maps, of the limits or boundaries of the redevelopment area pursuant to the redevelopment area plan;
 - (g) the procedure for review of the determination of individual property tax increments or the total property tax increment, pursuant to paragraph (9) below; and
 - (h) provision that the tax increment finance ordinance shall not become effective until the redevelopment area ordinance pursuant to Section [14-301] becomes effective.
- (6) A tax increment finance ordinance pursuant to this Section may establish sales tax increment financing.
 - (a) Before the end of the calendar month in which the tax increment finance ordinance becomes effective, the local government shall determine the base sales tax.
 - (b) Every [6] months, commencing with the calendar month directly following the month in which the tax increment finance ordinance becomes effective, the local government shall:
 - 1. determine the present sales tax;
 - 2. from that number and the base sales tax, calculate the sales tax increment; and
 - 3. deposit the sales tax increment in the special or separate account pursuant to paragraph (10) below within [15] days of the calculation.
 - (c) If the sales taxes levied by the local government are collected by another governmental unit, that unit shall:
 - 1. at least [15] days before the effective date of the ordinance, be provided by the local government with a description and map of the boundaries of the redevelopment area pursuant to the redevelopment area plan, and with the effective date of the tax increment finance ordinance; and
 - 2. make the calculations required by this paragraph every (6) months and remit the sales tax increment to the local government within [15] days of the calculation, whereupon the local government shall deposit the increment in the special or separate account pursuant to paragraph (10) below within [15] days of receipt.

- (7) Upon the request of a local government that is preparing a tax increment finance ordinance, said request including:
- (a) a description and map of the boundaries of the redevelopment area pursuant to the redevelopment area plan, with the map delineating the boundaries of the district in relation to tax parcel boundaries; and
 - (b) a list of the tax identification numbers for all lots or parcels in the redevelopment area,

the county [assessor *or equivalent official*] shall provide the local government with an enumeration of the total base property tax and all base individual property taxes for the redevelopment area.

- (8) Upon the adoption of a tax increment finance ordinance, the local government shall notify the county [assessor *or equivalent official*] of such adoption, including the boundaries of the redevelopment area. Thereafter, until the termination of the redevelopment area ordinance pursuant to Section [14-301(5)(m)], the county [assessor *or equivalent official*] shall, upon each assessment of property taxes pursuant to [*cite real property tax statute*]:

- (a) determine the present individual property taxes, individual property tax increments, total present property tax, and total property tax increment for the redevelopment area.
 - 1. The present individual property taxes for all lots or parcels in the redevelopment area shall be determined in the same manner as for any lot or parcel pursuant to [*cite real property tax statute*].
 - 2. The county [assessor *or equivalent official*] shall compare the total property tax increment to the sum of the individual property tax increments, and shall confirm that the total property tax increment equals the sum of the individual property tax increments;
- (b) include the amount of the base individual property tax and individual property tax increment, along with a brief description of tax increment financing and redevelopment, on each real property tax bill for the redevelopment area; and

- Taxpayers in the redevelopment area are thus informed of the manner in which their property taxes are being spent, and are aware that increases are not going into the general fund but specifically into the redevelopment of their area.

- (c) remit the total property tax increment to the local government and provide the local government with the data on present individual property taxes, individual property tax increments, total property present tax, and total property tax increment for the redevelopment area.
- (9) Any governmental unit that receives real property tax revenue and/or sales tax revenue from the redevelopment area may seek a review by the local legislative body of the determination of property tax increments and/or sales tax increments, as applicable. The procedure for such a review shall conform to the provisions of Chapter [10] of this Act for land-use decisions, and there shall be a record hearing on all such reviews.
- (10) The total tax increment, and all revenue from the sale of bonds or notes secured by total tax increment pursuant to Section [14-301(6)(a)], shall be deposited in a special interest-bearing account of the local government treasury, except as provided below.
 - (a) If the redevelopment area ordinance is to be implemented by a redevelopment authority pursuant to Section [14-301], the total tax increment, and all revenue from the sale of bonds or notes secured by total tax increment, may be deposited in a separate interest-bearing, federally-insured account at a bank.
- This provision allows the TIF funds to be deposited in a stable, but privately-owned, institution if and where the intent is to create a redevelopment authority that has a degree of independence from political influence.
 - (b) Except as provided in paragraph (10)(c) below, the funds deposited into the special or separate account, and the interest earned thereon, shall be expended only pursuant to the development area plan, as implemented by the development area ordinance pursuant to Section [14-301], to:
 1. finance the employment of redevelopment assistance tools and the implementation of the development area ordinance; and
 2. pay principal and interest on bonds or notes issued pursuant to Section [14-301(6)(a)] and secured by the total tax increment.
 - (c) If a redevelopment area ordinance is terminated pursuant to Section [14-301(5)(m)] and any funds are remaining in the special or separate account at that time, the funds shall be

[*Alternative A*]

remitted to the general fund of the local government
treasury.

[*Alternative B*]

conclusively presumed to constitute property tax
increments and sales tax increments in the proportion in
which such funds were deposited into the account and:

1. to the extent derived from property tax increments,
remitted to the county [assessor *or equivalent*
official] and distributed to all governmental units
that receive property tax revenue from the
redevelopment area in proportion to their real
property tax rates; and
2. to the extent derived from sales tax increments,
remitted to the general fund of the local government
treasury.