Iowa Fiscal Partnership

POLICY BRIEF

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Why Iowa Should Eliminate Sales Tax TIFs

As the Iowa Legislature moves towards adjournment, lawmakers should not miss the opportunity to put a quick end to a little-noticed tax provision that is both unfair and wasteful of local taxpayer dollars. At the end of the 2008 session, an appropriations bill made it into law and significantly changes the way the local option sales tax (LOST) operates, creating for the first time a "sales tax TIF." While TIF (tax-increment financing) has been used to divert property tax revenues to city development projects for decades, this bill allows a similar diversion of local sales-tax revenue. The sales tax TIF would negate citizen referenda, spell the demise of the best feature of Iowa's local-option sales tax, and guarantee a new round of wasteful competition among Iowa cities in the name of "economic development."

Revenue Sharing: A Key Feature of Iowa's LOST

The LOST is by far the largest local option tax available to cities and counties, diversifying the revenue base and relieving pressure on the property tax. Under Iowa law a proposed LOST must be voted on throughout the county, and the revenues collected in all places adopting the tax must be pooled and shared. This provision recognizes that retail activity is often concentrated in certain cities within a county, yet all residents of the county pay the LOST, and all should share in the revenues. Without this provision, a small city that is chosen as the site for a large regional mall, due perhaps merely to a fortuitous location at the intersection of major highways, would reap a revenue bonanza, most of it paid by residents of neighboring towns. Sharing the tax among all county residents, by apportioning it to cities and the county mostly by population, prevents this inequity.

Sales Tax TIF: The End of Revenue Sharing?

The 2008 law, if left in place, allows cities to circumvent the revenue sharing feature of LOST. Under the new sales tax TIF, a city can by ordinance designate an urban renewal area (an existing one, or a new one created for this purpose) as a sales-tax TIF district. From then on, all increases in LOST revenues collected from retailers in the urban renewal area are diverted from the countywide LOST pool and instead go into the city's TIF fund. Compounding the inequity, the ***city still gets its share of the countywide pool of taxes*** collected in every other city in the county.

Any city that is home to substantial retail activity now has a powerful incentive to create an urban renewal area around that retail tax base, if they don't already have one. It is not hard to imagine how this will play out over time. Suppose city A, with 40 percent of county retail sales, creates a sales tax TIF area that includes all retail activity. Neighboring city B sees their LOST revenue decline as city A diverts an increasing portion of the sales in A from the shared pool, while the LOST revenue collected within city B is still shared countywide. City B retaliates by creating its own sales tax TIF to avoid sharing future LOST revenue increases with their greedy neighbor. The likely eventual result is that every city with a sales tax base of any significance will TIF that base to protect its revenue stream. The

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pooling of revenues becomes ever smaller and the unincorporated county and small towns with little or no retail activity get little or no LOST revenue, but still have to shop in the neighboring cities and pay sales tax to them. That is why, in the long run, this law spells the effective demise of shared revenue, leaving rural Iowa footing the bill.

It is important to note that all increases in LOST become part of the increment, whether from new retail stores opening, existing stores selling more, or just inflation in prices. Thus over time, a larger and larger share of sales will be part of the "increment." If retail sales had been subjected to a TIF 15 years ago, by now inflation alone would have pushed one-third of sales into the increment, even with no growth in retail square footage or in population. And if a city creates an urban renewal area for a new mall, where no retail currently exists, *all* retail sales from the mall will immediately be "incremental sales" going exclusively to the city, even while the mall draws sales away from other retail areas that generate LOST revenues shared countywide.

The Sales Tax TIF Undercuts Voter Approval

While the LOST must first be approved in a countywide referendum, a city council can subsequently adopt the sales tax TIF simply by vote of the council. When citizens vote to approve a LOST they are voting for a tax that by law must be shared countywide according to formula. One city should not be allowed to unilaterally pull revenue out of that sharing agreement after the fact, negating a key feature of the tax as approved by voters.

Sales Tax TIF amounts to Piling On

The sales tax TIF can be adopted only in an urban renewal area, which is to say only in an area established to provide property tax TIFs. Property tax TIFs were designed to compensate a city for extra costs it incurs — for sewer lines or other infrastructure, for example — because of new business investment. There is no justification for providing the city with local-option sales tax revenue in addition, since the property tax TIF provides more than ample revenue to compensate a city for any extra costs it incurs.

Law Will Accelerate Property Tax TIF Growth and Further Erode State Revenues

The sales tax TIF gives cities another reason to create urban renewal areas. Developers will catch on quickly, upping their demands for subsidies, since the double TIF is now easily implemented. The rapid growth in TIF valuation that we have seen over the past two decades will be spurred further. Because TIF districts divert revenue that would otherwise have gone to other local taxing jurisdictions, most often school districts, additional growth in TIF valuation will mean that even more state revenues will be devoted to backfilling school aid.

Sales Tax TIF Encourages Unneeded Subsidies

A sales tax TIF is designed to subsidize development precisely where subsidies are least justified: for retail activity. As with the property tax TIF, the sales tax TIF revenue could and would be used to provide incentives to new retail development. But retail is not a footloose, export activity; it depends entirely on the existence of a local market. If the market can support a new mall, for example, developers will figure that out and build a mall. If the market can't support the mall, banks won't finance it and developers won't build it. Furthermore, *where* developers decide to build is driven by access to the market; incentives can't overcome a bad location, and they aren't needed if it is a good location.

There are only three possible effects of incentives for retail activity: (1) They raise a developer's profits for a project that was going to be built in that location anyway, wasting taxpayer funds for no gain in jobs or tax base; (2) They make possible a development that can't stand on its own and that therefore should not be built, using taxpayer funds to subsidize unprofitable development so it can compete with

existing retail that is standing on its own; or (3) They shift the location of a project within the same market area, with no gain in jobs or tax base for the region. Since retail developers must pick the location that maximizes sales, the third outcome is the least likely.

Sales Tax TIF Encourages Wasteful Competition Among Cities

Economies are regional. We need to encourage economic development practices that recognize this and that engage cities and counties in cooperative efforts to boost the region. As regions grow, all in the region benefit. The sales tax TIF law sends us further down the path away from cooperation and towards more intense competition. It creates powerful incentives for cities to compete with their neighbors to shift retail activity across the city line. Even if the TIF has no effect on location, it can have a powerful effect on city revenues, as the city that lands a new mall captures all the LOST from the mall, even while the mall robs sales from other retailers and reduces the shared revenue pool. This does nothing to bolster the regional economy. In fact, it harms it, as public dollars needed to fund infrastructure and schools that are important to the regional economy are diverted to wasteful subsidies.

The sales tax TIF law that passed in the last days of the 2008 legislative session should be repealed. What were they thinking?

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The Iowa Fiscal Partnership is a joint fiscal policy initiative of two nonprofit, nonpartisan Iowa-based organizations, the Child & Family Policy Center in Des Moines and the Iowa Policy Project in Iowa City. IFP reports are available at www.iowafiscal.org.

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