

# Rethinking Property Tax Incentives for Business

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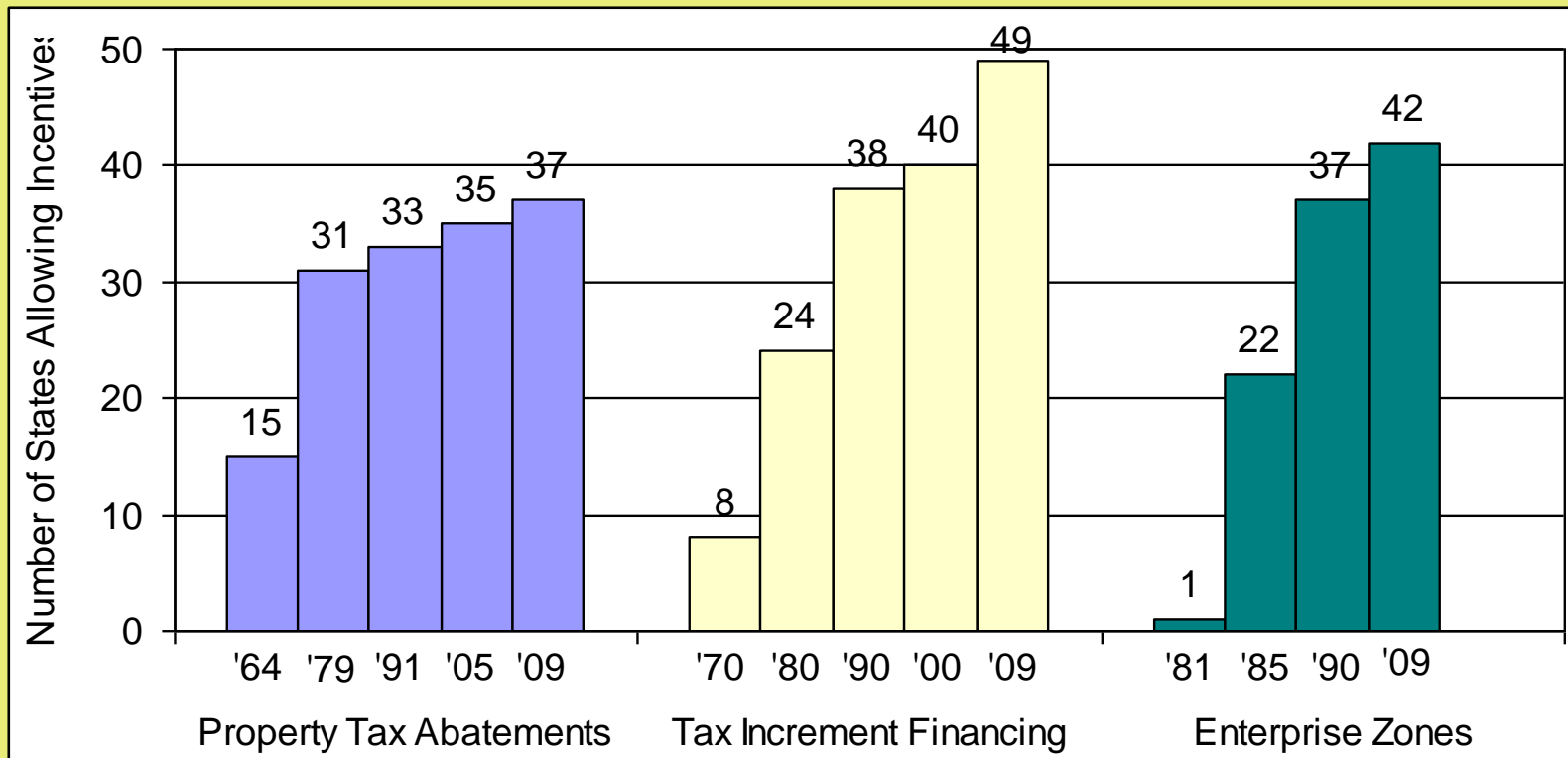
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## Rethinking Property Tax Incentives for Business



DAPHNE A. KENYON, ADAM H. LANGLEY, AND BETHANY P. PAQUIN

# Property Tax Incentives Allowed in a Growing Number of States



Sources: Wassmer 2009; U.S. PIRG Education Fund 2011;  
U.S. Department of Housing and Urban Development 1991

# Property Tax Incentives for Business are:

- Unlikely to affect firm's choice of metro area
- May affect firm's choice of site within metro area, but not if other jurisdictions offer similar incentives

# Impact of Property Tax Differentials on Firm Costs

## **Across States:**

- Small, easily outweighed by differences in other factors

## **Across Municipalities within Same Metro Area:**

- Substantial, often larger than differences in other factors

# Effect of Relocation on Total Costs for Average Manufacturing Facility

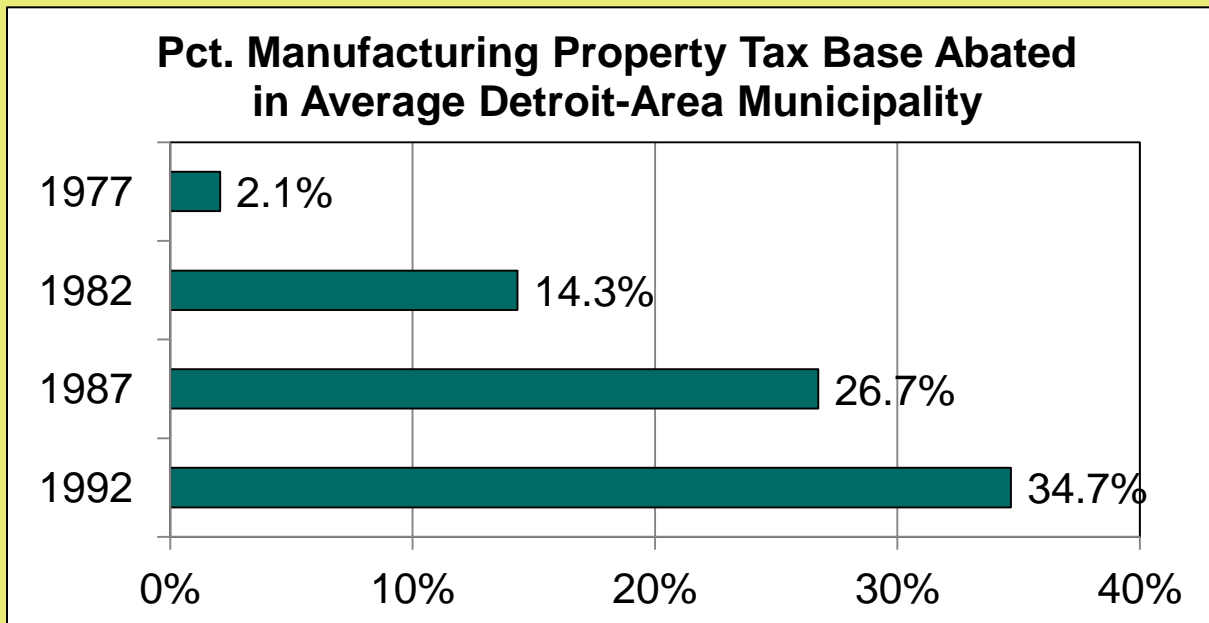
- State with 5<sup>th</sup> highest **property taxes** to 5<sup>th</sup> lowest
  - Total costs: **0.3%** ↓
- State with 5<sup>th</sup> highest **labor costs** to 5<sup>th</sup> lowest
  - Total costs: **3.4%** ↓

# Property Taxes Can Impact Choice of Site *Within* Metro Area But Not if Neighboring Jurisdictions Offer Similar Incentives

- Tax incentives work by altering **relative** tax costs
- Widespread use of tax incentives within metro area means firms can obtain similar tax breaks in many jurisdictions
  - Incentives less likely to affect location decisions

# Copy-Cat Behavior Reduces Effectiveness of Tax Incentives

- Anderson and Wassmer (2000): Prop tax abatements increase manufacturing property values **initially for first municipalities to use them within metro area**, but not in later years once incentives used widely



# Property Tax Incentives for Business are:

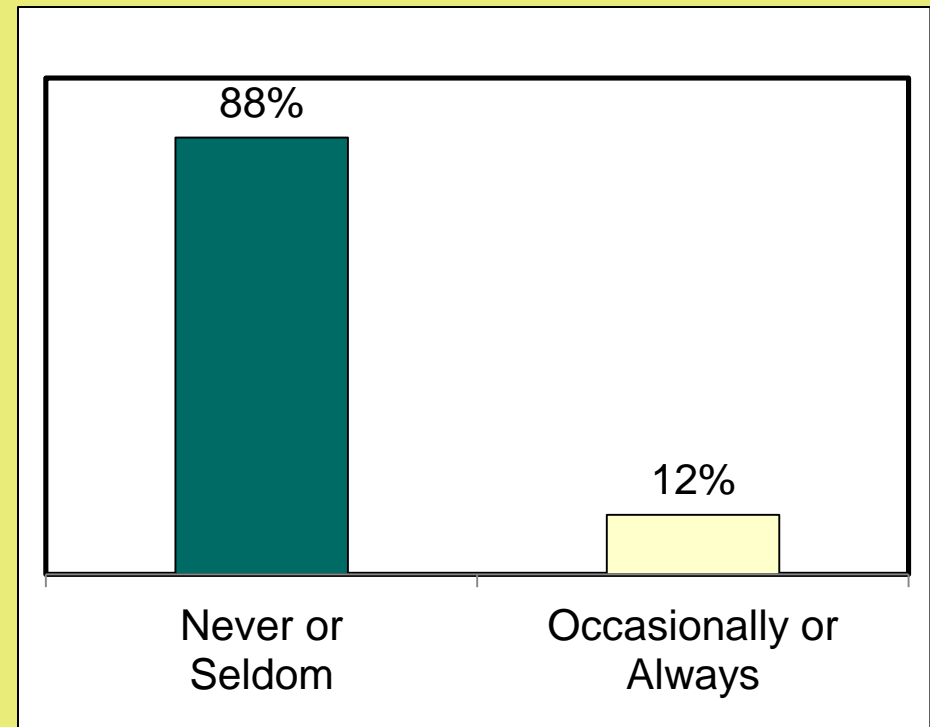
- Overused in general
- Sometimes given to firms that would have chosen same location without incentives



# Example: PT Abatements in Michigan

In Michigan, abatements are given to most firms that apply:

Q: How frequently have requested abatements been denied in your municipality?



Source: Sands and Reese (2012)

# Example: Speracor in Marlborough, MA

- In December 2008, the city awarded a 14-year \$3.8 million property tax exemption to the pharmaceutical company conditional on creating 250 new jobs and investing \$47 million.
- But tax breaks granted more than a year **after** the company had started construction on an expansion project.



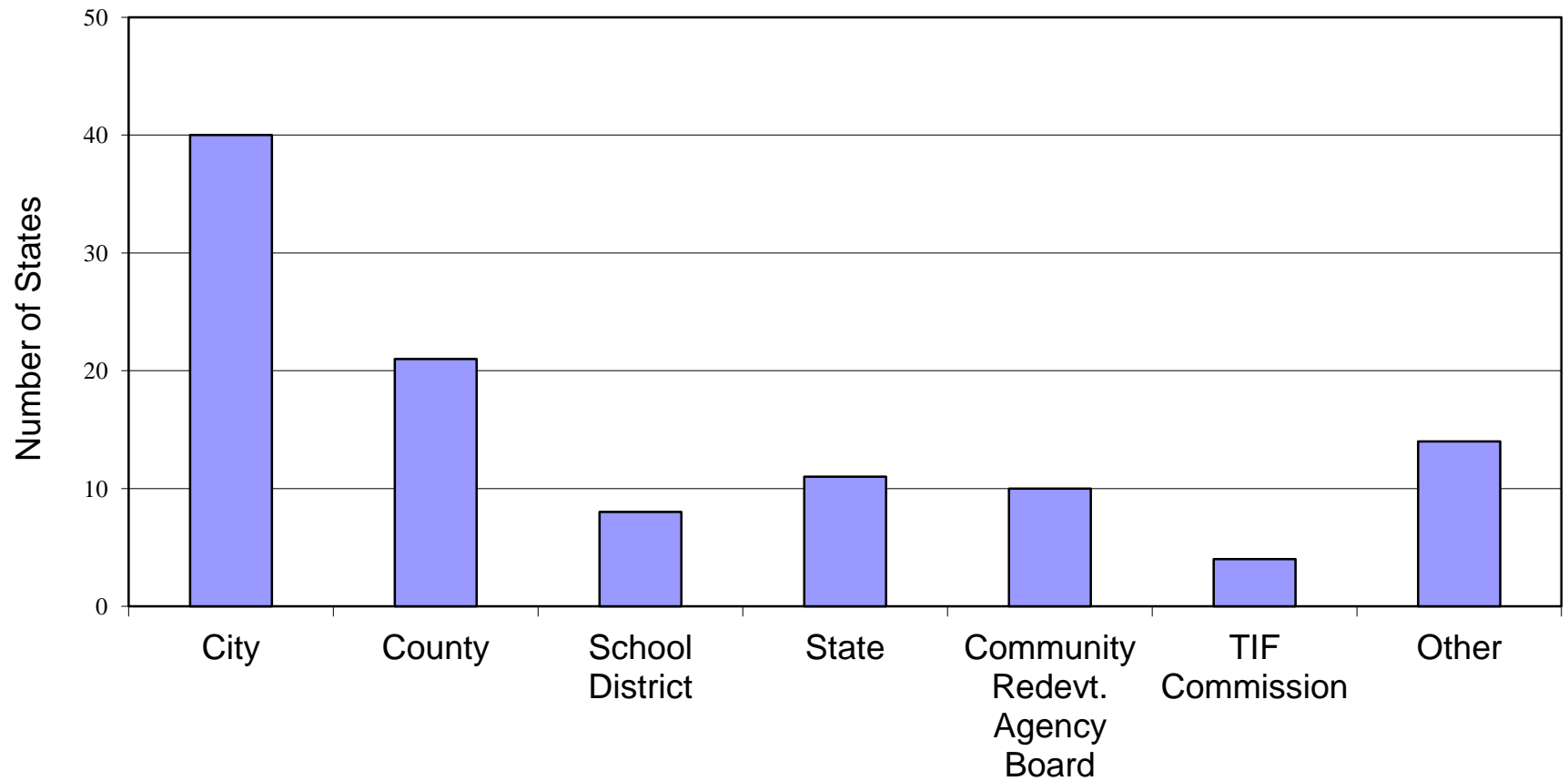
*Photo: Speracor Headquarters, 84 Waterford Drive, Marlborough, Massachusetts*

**Effects and effectiveness of PT incentive programs varies due to differences in program details**

# Tax Increment Financing (TIF)

- TIF is limited to designated geographic areas
- Within the TIF district, growth in property taxes or other revenues may be earmarked to support economic development in that area
- Usually tax increments are earmarked to fund infrastructure improvements

## Approval Agencies for Creation of a TIF District



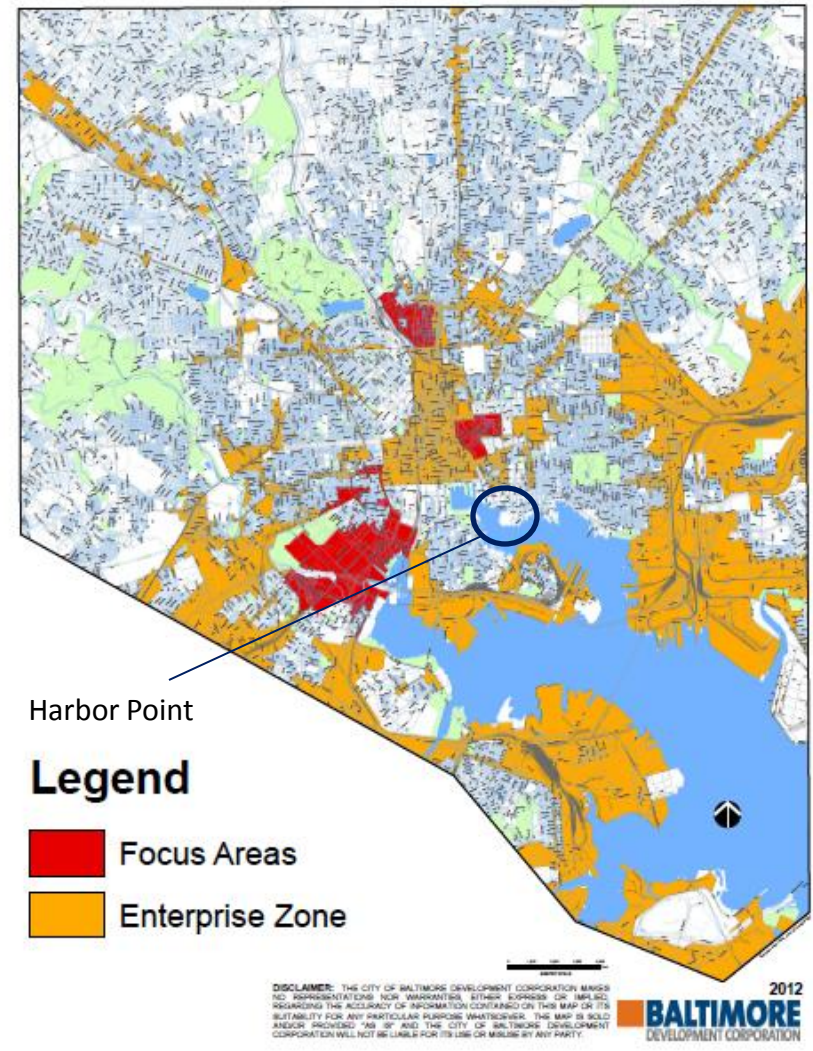
# Enterprise Zones

- Enterprise Zones are designated geographic areas, usually economically depressed
- Within the Enterprise Zone, state and/or local governments provide tax and other incentives to encourage business development
- The most common tax incentive in Enterprise Zones is a reduction in property taxes

# Enterprise Zones

## Case Study: Baltimore

- In June the City of Baltimore cut the city's enterprise zone by over 36 percent to remove flourishing waterfront areas and to include more of the central city
- Zone businesses are eligible for a 10-year, 30-80 percent credit
- In response to an appeal from developers from one of the eliminated areas, the city has added back Harbor Point pending state approval



# Firm-Specific Property Tax Incentives

- State and local governments sometimes allow partial or full reduction of property tax liability for specific firms
- Firm-specific property tax incentives are typically combined in a package including other types of incentives
- Incentives are offered on a case-by-case basis rather than through a pre-existing state program, usually with the purpose of influencing a relocation decision



# Firm-Specific Property Tax Incentives

## Case Study: Illinois and Sears

- Retail giant Sears Holdings threatened to move its headquarters out of Hoffman Estates, a suburb of Chicago, last year after the State of Illinois hiked its corporate tax rate
- The company demanded \$15 million per year in tax incentives to remain in Illinois where the company has been based for 125 years
- Other states attempted to lure Sears with huge tax incentive packages, including a \$400 million offer from Ohio

# Firm-Specific Property Tax Incentives

## Case Study: Illinois and Sears

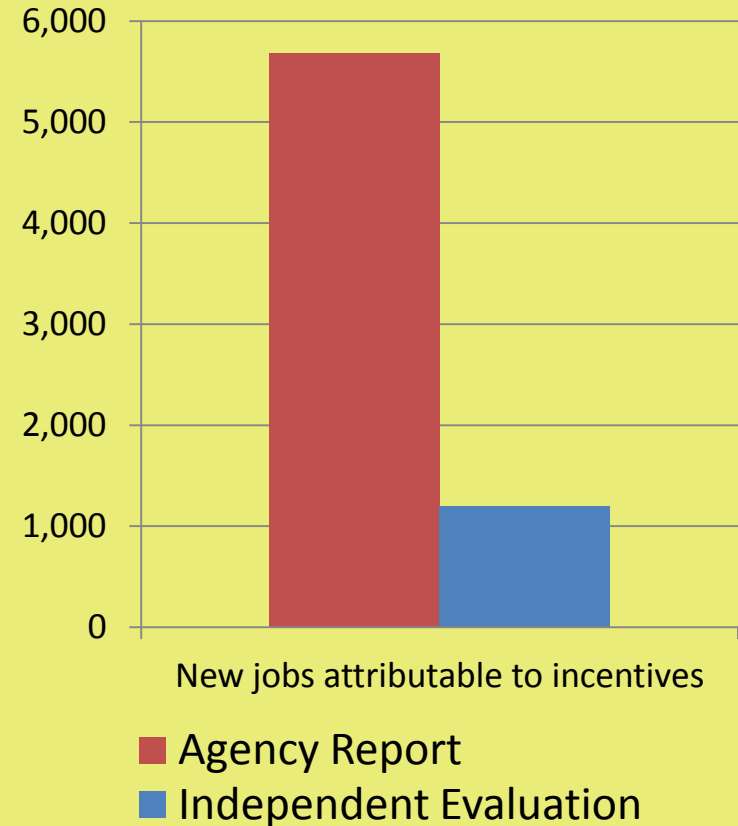
- The legislature passed legislation that included the tax incentives Sears had requested, contingent on investment and retaining a minimum number of jobs
- Sears praised the deal and announced it would keep its headquarters in state
- In the months after the governor signing the bill, Sears announced nationwide store closings and layoffs at its Hoffman Estates headquarters

# Lack of Transparency and Evaluation

- Currently 44 states produce tax expenditure reports, but only eight states include tax expenditure estimates for the local property tax
- A recent study found 16 states did not publish a document between 2007 and 2011 that assessed the effectiveness of a tax incentive

# Importance of Independent Evaluation

- Independent evaluation of Minnesota's JOBZ program estimated:
  - number of jobs attributable to the incentives was much lower than previously reported
  - cost per new job was about five times higher



# Recommendations

## Three Levels of Recommendations

Consider Alternatives

Local Reforms

State Reforms

# Consider Alternatives

## Non-Tax Alternatives

### Most Effective

**Customized Job Training:** These programs provide training designed to meet the specifications of each firm

**Labor Market Intermediaries:** The programs match unemployed workers with firms looking to hire

**Regulatory Assistance:** Government staff assists firms with complex regulations and taxes, providing information and resolving state and federal issues

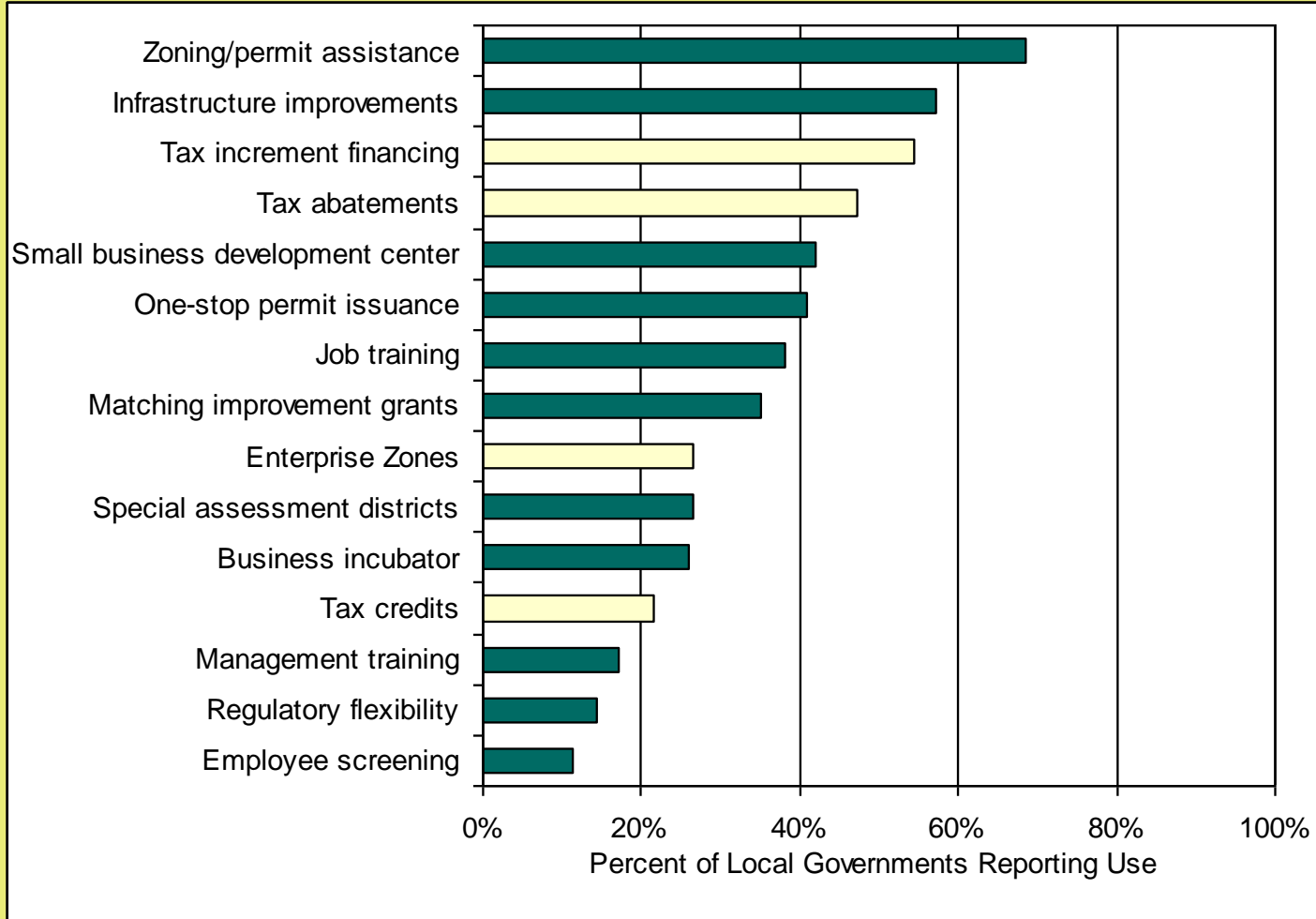
# Consider Alternatives

## Non-Tax Alternatives

### Moderately Effective

**Worker-Oriented Job Training; Incubators; Business Services; Business Improvement Districts (BIDs)**

# Local Policies Use to Promote Business Development (2009)



Source: International City/County Management Association. Econ. Dev't 2009 Survey Summary.



# Local Reforms

## Recommendations

- Set criteria for incentives
- Limit incentives to mobile facilities that export goods/services out of region
- Place limits on the number or total dollar value
- Enforce open process for deciding on incentives
- Cooperate with other localities

# Local Reforms

## Criteria for Granting Local Tax Incentives

**Question 1:** Will the firm asking for tax incentives locate elsewhere with a significantly high probability?

Yes

No

Do not grant incentive

**Question 2:** Will offering tax incentives make the firm's probability of locating in your jurisdiction higher than in other alternative locations?

Yes

No

Do not grant incentive

**Question 3:** Will granting incentives that attract the facility improve your jurisdiction's fiscal health (i.e., expected taxes and fees paid by the firm exceed the cost of new services)?

Yes

No

Grant incentive

**Question 4:** Is the increased fiscal stress more than offset by other benefits of having the facility locate in your jurisdiction (i.e. Jobs for residents, attraction of other firms, or urban revitalization)?

Yes

No

Grant incentive

Do not grant incentive

# State Reforms

## Restrict Proliferation of Tax Incentives

Incentives are more likely to be beneficial when used in areas with:

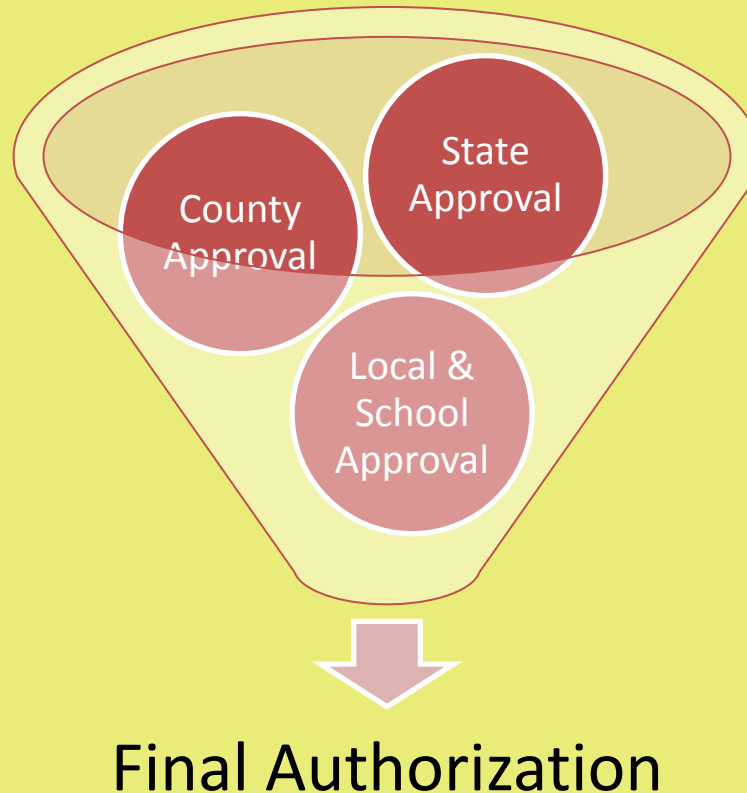
- High unemployment
- Low Incomes
- Underutilized infrastructure

States can:

- **Limit the number of local governments permitted to use incentives**
- **Restrict the use of incentives to communities where they are most needed**

# State Reforms

**Require tax incentives be approved by all affected governments**



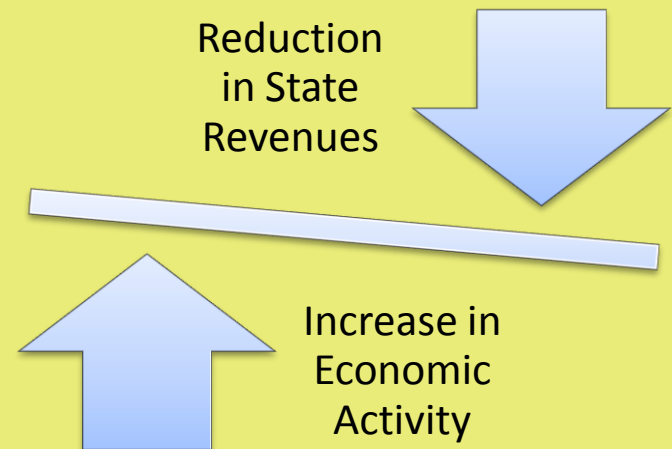
# State Reforms

## Example: Arizona

- Some states reimburse local governments for revenue foregone as a result of property tax incentives, so local governments do not bear the cost of the incentives they provide
- The State of Arizona passed legislation in 2007 to penalize local governments in the Phoenix area by withholding state aid from communities that used tax incentives to compete with other area communities

# Example: Connecticut

- In 2010, the State of Connecticut passed a law requiring periodic fiscal assessments of the state's tax credit and abatement programs
- A resulting report recommended eliminating the Enterprise Zone property tax abatement, finding the costs of the program exceeded its benefits



# Conclusion

- Property tax incentives for business are costly and often ineffective
  - Consider alternatives
- If your state is going to use incentives
  - Set criteria for granting incentives
    - For example, limit them to mobile facilities that export goods/services out of the area
  - Do not grant incentives to all businesses that ask for them
  - Disclose information on incentives and evaluate them for effectiveness

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