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No tax relief until we see TIF reform

By Peter S. Fisher

Owners of shopping malls, office towers and apartment buildings in Iowa argue that they are paying too much in property taxes. They appear to have gotten a sympathetic ear among Iowa legislators and Gov. Chet Culver.

But despite much fanfare surrounding the issue early in the last legislative session, the Iowa General Assembly was unable to produce a bill dealing with the problem. The reason is quite simple: If commercial taxes are reduced, someone else has to pick up the tab, and no one wants to take the blame for doing that.

The overall system

Is there really a problem here? Property taxes are not driving business out of Iowa, as some claim. Property taxes are just part of the overall system of state and local taxes. Businesses that occupy commercial real estate are also taxed under the corporate or personal income tax. Iowa's personal income tax level is about average, and the corporate income tax in Iowa is well below average. Furthermore, researchers have examined the overall level of business taxation (including property taxes) and found that Iowa is about average among the 50 states.

State-local taxes are a small share of the cost of doing business at any rate. Research has shown, in fact, that tax levels have little to do with how a state's economy grows. Furthermore, commercial property is the prime beneficiary of tax abatements and subsidies through tax increment financing (TIF). Much new commercial investment pays far less than the nominal property tax rate because of these incentives.

This is not to say that there are no problems with the property tax in Iowa. The rollback system that reduces residential and agricultural assessments was designed to prevent a large shift in property taxes to residential property, and it has succeeded admirably.

But it has also produced a situation in which commercial owners pay on all of the market value of their property, while homeowners now pay on less than half the value. As a result, an apartment building will pay over twice the property taxes that would be due on an identical building that has units owned as individual condos, because the condos are considered residential property. In a few years, residential assessment rates could fall to 33 percent, at which point the apartments will pay three times the rate on condos.

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This tax disparity creates a powerful incentive to convert apartments to condos, or to build condos instead of apartments, which creates a scarcity of rental property and keeps rents high.

Other issues of fairness

There are other issues of fairness. Older Main Street businesses are paying commercial property taxes without the relief afforded many newer businesses through TIF incentives and abatements. This is not a level playing field. And cities are using TIF ever more aggressively, shifting the cost of city services to rural and state taxpayers and, in many cases, wasting tax dollars on incentives that do nothing for real economic development.

The residential rollback system needs to be reformed. Local governments cannot keep pace with inflation and the needs of a growing population when the rollback formula continues to shrink a large chunk of the tax base. Decisions about building apartments vs. condos should be based on market conditions, not a peculiarity of the tax system. Solving these problems requires that we freeze the residential rollback and then begin moving at least part way back to a system based on market value.

Any substantial reductions in taxes on commercial property should also address the inequities and waste inherent in Iowa's system of tax increment financing. There should be no commercial property tax relief without some substantial TIF reform.

Property tax reform will not be easy; someone will have to pay for it. TIF reform could, in fact, provide some of the funds. And while failure to enact drastic reductions in commercial property taxes will not lead to economic ruin, the rollback system cannot continue in its present form forever. Let's hope that the next session of the Legislature begins to tackle the long-term problems with Iowa's property tax system.

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