INDIANA TAX INCREMENT FINANCING LAW: CHALLENGING THE COMMON MISCONCEPTION THAT ALL FUNDS ALLOCATED TO TIF DISTRICTS WOULD OTHERWISE PROVIDE ADDITIONAL FUNDING FOR SCHOOL CORPORATIONS AND OTHER UNDERLYING TAXING UNITS (INCLUDING A DISCUSSION OF THE IMPACT OF TAX CAPS)*

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Note: These materials are intended for information only and are not to be considered legal advice.

CHALLENGING A COMMON MISCONCEPTION IN INDIANA'S TAX INCREMENT FINANCING LAW

A widespread misconception exists concerning tax increment financing districts in Indiana (commonly referred to as "TIF Districts"). This misconception is an assumption that if funds were not deposited into the TIF District allocation fund, those funds would instead flow to the underlying taxing units (i.e., those taxing units with territory in the TIF District among which property taxes are normally divided, including the school corporation, the city or town, the county unit, the library district, the township, etc.), in proportion to the percentage of the particular taxing unit's share of the total tax rate. For example, if a TIF District is generating $500,000 in tax increment revenues in a particular year, it is commonly assumed that, if the TIF District were not in place, a school corporation whose tax rate is 40% of the total tax rate captured by the TIF District would have received $200,000 of additional revenues (i.e., 40% times $500,000). This is a significant misconception, for the reasons described below.

1. Funds of cities, towns and counties.

    a. General Fund. Cities, towns and counties usually have as their most important fund the "General Fund," which is usually funded primarily from a tax levy on taxable property in the particular taxing unit. The General Fund of a city, town or county is in the category of a "**levy limited fund**." meaning that a statutory cap is placed on the total dollars that can be raised for this fund. Adding to the assessed valuation of the governmental unit might permit a reduction in the tax rate, but would not result in the generation of additional funding for this fund. (This is true, since increasing assessed value ("AV") will decrease the tax rate ("R"), where the product of the two (AV time R) is capped.) For levy limited funds, Indiana law places a limit on how much in additional dollars can be raised for the fund over the prior year's maximum. In recent years, the maximum increase has been limited to 2-3%. (The maximum percentage increase is determined based on the average growth of non-farm personal income in Indiana over the prior six-year period, up to a maximum of 6%.)

    b. Cumulative Capital Fund. Cumulative capital funds are "**rate limited funds**." In the case of a "rate limited fund," the maximum dollar amount that can be raised for the fund is not limited; instead, the rate has a maximum limit, and the rate imposed is applied to all of the assessed value available to the local governmental unit. Accordingly, for this fund, freeing up assessed value from a TIF District would be expected to generate additional money for the fund.

2. Funds of school corporations. School corporations in Indiana are generally permitted to establish the following funds:

    a. General Fund. This is generally a school corporation's most important fund. Prior to 2009, all or a portion of a school corporation's General Fund was

funded by local property taxes. However, beginning in 2009, the responsibility for funding the General Fund was transferred from the local property tax base and moved to the State. Based on a statutory formula, the State provides the funding for each school corporation's General Fund from State revenues (including State sales tax revenues). Therefore, the creation of a TIF District has NO IMPACT on revenues available to a school corporation for its General Fund.

b. Debt Service Fund. This fund is created when the school corporation incurs long-term debt. Amounts raised for this fund are based on the amount of the annual debt payment due. More money would not flow into this fund if assessed value were freed up from a TIF District.

c. Capital Projects Fund. This is a "rate limited fund," and is permitted to be used only for specified statutory purposes, generally relating to the acquisition or construction of capital assets such as land, buildings and equipment. Since the Capital Projects Fund is a "rate limited fund," the maximum dollar amount that can be raised for the fund is not limited; instead, the rate has a maximum limit, and the rate imposed is applied to all of the assessed value available to the school corporation. Accordingly, for this fund, freeing up assessed value from a TIF District would be expected to generate additional money for the fund.

d. Transportation Funds (consisting of a Transportation Operating Fund and a Bus Replacement Fund). These funds are "levy limited funds," and therefore a statutory cap is placed on the total dollars that can be raised for these funds. Accordingly, adding to the assessed valuation of the school corporation might permit a reduction in the tax rate, but would not result in the generation of additional funding for these funds.

3. Effect of Tax Caps on the Amount of Money that Can be Raised for Various Local Funds.

   a. Beginning in 2007, Indiana law imposed caps on the maximum tax burden that could be placed on particular classes of taxable property, with certain property having a cap equal to 1% of the gross assessed value of the property (as in the case of a home where the taxpayer lives), 2% of gross assessed value in the case of certain other classes of property (including, for example, residential rental property), or 3% of the gross assessed value in the case of certain other classes of property (including for example, commercial property). Prior to the enactment of tax caps in Indiana, levy limited funds were entitled to receive the full amount of the maximum permitted levy amount, equal to the net assessed value available to the taxing unit times the tax rate. Similarly, rate limited funds were entitled to receive the full amount of money that the available net assessed value, multiplied by the tax rate, would produce. The tax caps added an additional limitation on the amount of

money that a fund could receive, by placing a limit on the maximum percentage of gross assessed value that could be imposed on the various classes of taxable property.

b. When tax caps are exceeded, various funds experience a reduction in the amount of money they receive. That reduction can be eliminated if enough additional assessed value is made available to the taxing unit to bring the tax rates low enough to eliminate the loss due to the impact of the tax caps (since, all other things being equal, the more assessed value available, the lower the tax rate can be). Transferring assessed value away from a TIF District and making it available to the taxing unit would be one way, among many other, of reducing or eliminating the loss caused by the tax cap.

c. As a general matter, anything that either increases available net assessed value or reduces the tax rate below the tax caps will have the effect of restoring all or part of the loss created by the tax caps.

i. In addition to the existence of a TIF District, many other factors can affect the level of the assessed value available to a taxing unit. Such factors include, among others, the success of the taxing unit in attracting new investment that adds to the tax base (which is one of the principal reasons behind the enactment of TIF laws); loss of businesses (which the TIF laws are designed to help avoid); State law policies relating to exemptions of various classes of property from taxation; the right of a taxpayer in certain cases to receive a deduction in the assessed value of taxable property; local tax assessment practices; and transfers of taxable property to non-taxable owners.

ii. Many factors can impact whether tax caps will be exceeded, including, among others, the existence or increase in the amount of debt payable from property taxes that is incurred by any of the overlapping taxing units; the existence or creation of a cumulative capital fund; the tax rates of other overlapping taxing units; and access to other, non-property tax sources of funds, such as local income taxes or various revenues from the State.

SUMMARY

In summary, the freeing up of assessed value from a TIF District does not generally result in an increase in revenues for cities, towns and counties, with the principal exception being cumulative capital funds. Similarly, the freeing up of assessed value from a TIF District does not generally result in an increase in revenues for a school corporation, with the principal exception being the Capital Projects Fund. In addition, although transferring assessed value away from a TIF District and making it available to a taxing unit could reduce or eliminate the impact of tax caps, it seems appropriate to view the tax caps themselves as the cause, in the first instance, of the loss of revenues available for particular local funds, rather than the existence of the TIF District.

Moreover, as discussed above, the capture of assessed value by a TIF District is only one of many factors that can impact the availability of additional assessed value for a taxing unit. At the same time, many factors bear on whether the tax caps are exceeded for a particular taxing unit. Finally, in many cases, the increase in assessed value would not have arisen in the first place (and therefore would not be available to transfer to the underlying taxing units) if a TIF District had not been created to induce the development that generated the additional assessed value. Indiana law allows Redevelopment Commissions to mitigate the impact of the tax caps by annually passing through to the underlying taxing units all or a portion of the captured assessed value in a TIF District. Similarly, Indiana Code 36-7-25-7 effectively permits Redevelopment Commissions to provide a specified portion of available TIF revenues to school corporations for specified purposes.