MUNICIPAL BUSINESS TAX INCENTIVES

INTRODUCTION

There are three categories of business tax incentives employed by local governments: 1) infrastructure development, 2) economic revitalization and 3) economic development.

In Arizona, much of the debate regarding municipal tax incentives has centered on municipalities offering an incentive to businesses that would likely develop in the local area regardless of any incentive offered.

This issue brief describes the use of the three categories of municipal business tax incentives and discusses Arizona’s Government Property Lease Excise Tax (GPLET) and recent Arizona legislative activity relevant to these types of incentives.

INCENTIVES

Infrastructure Development

Tax incentives may be offered in exchange for a developer paying the initial costs of public infrastructure construction. Arguments in favor of this type of incentive suggest that it can be more cost effective for the taxpayers as there are no initial costs for the municipality or interest payments resulting from bond financing. Additionally, developers may have more flexibility with the timing of a project if they are responsible for the infrastructure, rather than being dependent on a municipality’s timetable.

Tax incentives may also be provided to existing businesses that are impacted by public infrastructure improvements. Street widening or realignment projects can temporarily or even permanently impact an existing business’ street access, customer visibility or expansion potential. Tax incentives can be provided to offset the cost to the business for things such as street entrance, parking lot or signage modifications needed to adjust to the public infrastructure changes.

Economic Revitalization

Tax incentives are used in blighted or declining areas to allow local businesses to reinvest the tax savings back into their business.
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In theory, by encouraging reinvestment, the area is less likely to fall into further decline and more likely to improve. Tax incentives are sometimes offered to attract businesses to particular neighborhoods within a municipality. One example would be to offer a tax incentive to attract a supermarket to an economically depressed neighborhood. Tax incentives are also used to encourage infill development. In most cases, land in outlying incorporated or unincorporated areas is more attractive because it is relatively unencumbered when compared to infill property, which can have multiple owners and many other obstacles such as ground contamination from previous or nearby uses or existing structures already on the property.

Economic Development

As previously mentioned, the largest criticism regarding tax incentives directed at municipalities is that, in some circumstances, they are offered to businesses that would locate in the area even if the tax incentives were not offered; especially when this results in neighboring cities engaging in bidding wars for a particular business.

However, proponents of tax incentives argue that in many instances a large-scale development or even a smaller business would not be built without an incentive. For example, some upscale retail stores limit their expansions and the awarding of a new location is a highly competitive process. The ability to offer a tax incentive can be the determining factor.

Tax incentives can also be used to foster the local development of businesses and jobs related to emerging markets. For example, proponents argue that creating a local base for the development of emerging technologies has tremendous economic potential. The location of such institutions is highly competitive with international competition in addition to the domestic. Once the base is created, it is argued that the area becomes the logical location for future related institutions and industries to locate as the technology emerges.

Government Property Lease Excise Tax

The GPLET was enacted in 1996 (Laws 1996, Chapter 349) to replace the tax on possessory interests that was repealed in 1995. GPLET is a local excise tax that is based on the square footage of a building rather than on its value. GPLET is levied on entities that lease the property of a city, town, county or county stadium district for commercial or industrial purposes for at least 30 days. The tax rate ranges from $0.75 per square foot to $3.10 per square foot inside a redevelopment area and $0.75 per square foot to $4.65 outside a redevelopment area, depending on the height and use of the building or structure. See ARIZONA LEGISLATIVE ACTIVITY for further requirements.

Proponents of the GPLET assert that the private entity is using its tax advantage to promote public good, such as tourism, spring training baseball or economic development. Opponents argue that GPLET reduces the property tax base and shifts the property tax burden from the private entity to competitors or individuals and also pits cities against each other in bidding wars for a particular business.

ARIZONA LEGISLATIVE ACTIVITY

Laws 2010, Chapter 321, modifies the prior GPLET structure by significantly increasing the GPLET rate and imposing additional restrictions on the ability of a city or town to abate the tax for the eight-year period.

GPLET leases that are either entered into before June 1, 2010 or authorized under a development agreement, ordinance or resolution approved before June 1, 2010, are taxed under the prior GPLET rate and governed by the prior requirements for the tax abatement.

The legislation also eliminates the reduction in GPLET rates that was provided to older buildings. It does, however, allow for the new GPLET rate to be adjusted based on a comparison between the ad valorem property tax rate applicable to the property and the county-wide average of combined property tax rates in the year in which the parties enter into the lease.
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Under the previous GPLET taxing structure, the government lessor was required to abate the tax for a period of eight years if the property was located within a “single central business district” within a redevelopment area and the improvements made to the property by the developer increased the property’s value by at least 100%. The new legislation creates additional requirements that restrict the availability of the eight-year abatement. Specifically, only cities and towns may authorize the abatement of the GPLET, and then only if the property is located within the city or town’s “central business district.” A city or town must notify the county, and any city, town or school district in which the property is located, at least 60 days before the city or town’s approval of the GPLET lease. That approval must contain a finding that, within the term of the lease or development agreement, the economic and fiscal benefit to the State of Arizona and the county, city or town in which the property is located will exceed the benefits received by the lessee as a result of the development agreement. The finding must be based on an estimate prepared by an independent third party.

The legislation further restricts the areas of the city or town that may be designated as "central business district.” A city or town is prohibited from designating more than one district within its corporate boundaries, or from approving a new lease or development agreement within one year of making the designation. It also limits the district to a redevelopment area that is no larger than the greater of 5% of the total land area within the exterior boundary of the city or town or 640 acres.

ADDITIONAL RESOURCES

- GPLET: Arizona Revised Statutes; Title 41, Chapter 10, Article 5
- Retail Business Location Municipal Tax: Arizona Revised Statutes § 42-6010
- Arizona Department of Commerce http://www.azcommerce.com/
- League of Arizona Cities and Towns www.azleague.org
- City of Phoenix www.phoenix.gov