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Tax Abatement in Indiana – A Proposal to Replace the Statement of Benefit with a Cost-Benefit Formula Based on the Expected Tax Revenue Generated by the Prospective Property Improvements

Peter D. Todd

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Todd: Tax Abatement in Indiana – A Proposal to Replace the Statement of

TAX ABATEMENT IN INDIANA - A PROPOSAL TO REPLACE THE STATEMENT OF BENEFIT WITH A COST-BENEFIT FORMULA BASED ON THE EXPECTED TAX REVENUE GENERATED BY THE PROSPECTIVE PROPERTY IMPROVEMENTS

In calculating the benefits of granting a tax abatement, communities need to be skeptical of corporate promises of quality jobs, and high wages. These factors are just too nebulous to quantify.¹

I. INTRODUCTION

On July 15, 1997, the Indianapolis Star reported the expansion of a manufacturing facility for Creative Expressions Group, a maker of paper party goods.² The New York based company pledged to invest approximately \$4.4 million in new equipment and add fifty new jobs to its Indianapolis facility.³ Among these new jobs were journeymen printers and maintenance workers whose positions paid them \$17.00 an hour in wages and benefits.⁴ In addition to creating the new jobs, the company pledged to produce high-quality paper plates and napkins at a lower cost with environmentally friendly inks.⁵ Based on these

¹ Telephone interview with David Germain, President/CEO of the Greater Elkhart Chamber of Commerce, in Elkhart, Indiana. (Feb. 11, 1998).

² *Creative Expressions Group to Hire 50 New Workers at its Eastside Plant*, INDIANAPOLIS STAR, July 15, 1997, at D5 [hereinafter *Creative*]. See also Mason King, *Western Electric Savors Preparing to Sell*, 18 INDIANAPOLIS BUS. J. 26 (1997).

³ *Creative*, *supra* note 2.

⁴ *Id.* The projected hourly wage of \$17.00 an hour would guarantee the new employees a wage of \$35,360 a year (\$17.00 per hour X 2,080 hrs. in a year). This calculation is based on a typical work schedule of eight hours a day or 40 hours a week. MARK A. ROTHSTEIN & LANCE LEIBMAN, EMPLOYMENT LAW 356 (3d ed. 1994). In 1995, the average annual wage per job paid to an employee in Marion County was \$28,815. INDIANA UNIV. KELLY SCH. OF BUS., THE INDIANA FACT BOOK 1998-99, at 292 (1998) [hereinafter *FACT BOOK*]. Consequently, had Creative Expression met its projected wage level, its employees would be making \$6,545 a year above the county average (\$35,360 - \$28,815 = \$6,545). Additionally, Marion County saw a 2.9% decrease in the number of manufacturing jobs over the period of 1990 to 1995. *Id.* at 293. Therefore, a project that would bring 50 new employees to the area would be attractive to the community.

⁵ *Creative*, *supra* note 2. Indianapolis lists printing and publishing, as well as paper and allied product, as two of its major industries. See 3 CITIES OF THE UNITED STATES: THE MIDWEST 71 (Peggy Saari & Diane L. Dupius eds., 1990) [hereinafter *CITIES*]. Consequently,

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corporate promises, Indianapolis gave Creative Expressions a five-year tax abatement worth about \$150,000.⁶ One year later, Creative Expressions Group stunned its workforce and the city by announcing the closure of its Indianapolis manufacturing facility.⁷

The closing, which resulted in the loss of 175 workers, was a result of the company's need to cut duplicative costs.⁸ After the closing, the city planned on revoking the company's tax abatement and forcing the company to return any money saved because of it.⁹ As a consequence of the closing, the workers grew increasingly unsure of their economic future.¹⁰

The Creative Expressions closure is one of countless examples of a community granting a tax abatement to a company and relying on the company's investment to improve its local economy, only to be disappointed when the company fails to deliver on its promises.¹¹ As this Note will demonstrate, corporations are convincing communities throughout Indiana to forego tax revenue in exchange for promises of positive economic impact. All too frequently, these corporate promises never materialize, while communities are being manipulated into giving up necessary tax funds by corporate promises of "quality" jobs and "high" wages.¹²

The purpose of this Note is to analyze the current problems that communities face when they grant a company's request for abatement.¹³

the retention or expansion of these industries is of particular importance to the Indianapolis area.

⁶ King, *supra* note 2, at 26. Indianapolis lists tax abatements as a local business incentive along with training grants and infrastructure grants. Indianapolis Econ. Dev. Corp., *Incentives* (visited Feb. 9, 1999) <<http://www.bit-wise.com/iedc/incent.htm>>. A Corporation that is interested in receiving an abatement must apply to the Indianapolis Economic Development Corporation, a not-for-profit corporation that is dedicated to the economic growth of Indianapolis. Indianapolis Econ. Dev. Corp., *IEDC Mission* (visited Feb. 9, 1999) <<http://www.bit-wise.com/iedc/Mission.htm>>.

⁷ *Decision to Close Plant, Cut Jobs Shocks Workers*, INDIANAPOLIS STAR, July 17, 1998, at C1 [hereinafter *Decision to Close Plant*]. The corporation has a production facility in Appleton, Wisconsin, that will be producing the products that were made in Indianapolis. *Id.* The likelihood of Indianapolis recovering the abated taxes is questionable. See *infra* notes 114-23 and accompanying text.

⁸ *Decision to Close Plant*, *supra* note 7.

⁹ *Id.*

¹⁰ *Id.*

¹¹ See *infra* notes 73-123 and accompanying text.

¹² See *infra* notes 73-123 and accompanying text.

¹³ See *infra* notes 73-123 and accompanying text.

Additionally, this Note suggests that the State of Indiana should alter its current tax abatement requirement for a Statement of Benefits to include a cost-benefit formula.¹⁴ Section II will outline the current policy and procedures in granting tax abatements.¹⁵ This Section will use as examples several local grants of abatement and the Indiana Code to demonstrate how easily a company can receive a tax abatement.¹⁶ Section III will illustrate the difficulty that communities face in accessing and receiving the benefits promised to them by companies that have received abatement.¹⁷ Finally, Section IV will propose a modification to the Indiana Code that enables local communities to grant tax abatements while reducing the risks that are inherent in the current tax abatement scheme.¹⁸ This change, if implemented, will help to insure that Indiana communities will receive a reasonable rate of return on their investment by linking abatement to the increase in value that the company creates by locating to a certain piece of property. This Note further suggests that the state legislature use the federal discount rate as a benchmark for what constitutes a reasonable rate of return.

In basic terms, this modification centers on a formula that calculates the rate of return a community receives from granting abatement.¹⁹ This rate will be a function of the community's actual costs associated with the project,²⁰ the increase in the property value created by the corporate investment,²¹ and the abatement schedule selected for the project.²² By focusing the decision of granting abatement on the above factors, Indiana communities will be able to identify beneficial projects, reject unfavorable requests for abatement, and have greater success in achieving the economic development²³ goals that the state has intended.

¹⁴ See *infra* notes 124-72 and accompanying text.

¹⁵ See *infra* notes 24-72 and accompanying text.

¹⁶ See *infra* notes 24-72 and accompanying text.

¹⁷ See *infra* notes 79-106 and accompanying text.

¹⁸ See *infra* notes 124-72 and accompanying text.

¹⁹ See *infra* notes 153-55 and accompanying text.

²⁰ See Matthew Schaefer, *State Investment Attraction Subsidy Wars Resulting From a Prisoner's Dilemma: The Inadequacy of State Constitutional Solutions and the Appropriateness of a Federal Legislative Response*, 28 N.M. L. REV. 303, 324 (1998). These non-tax costs include infrastructure, low-interest loans, job training, and land grants. *Id.*

²¹ See *infra* note 145 and accompanying text.

²² See *infra* note 68 and accompanying text.

²³ Economic development is the process of improving the standard of living and well being of the population of a community by raising per capita income, and is based primarily on the increase in industrialization. DAVID W. PEARCE, *THE MIT DICTIONARY OF MODERN ECONOMICS* 119 (4th ed. 1992). The State of Indiana has an entire department, the Indiana Department of Commerce, dedicated to the economic development of the State.

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This approach to abatement allows communities to base their decision to grant abatement on at least one quantifiable factor while minimizing the administrative costs of granting corporate requests for abatement. Ultimately, this method for determining the applicability of abatement will insure communities against empty corporate promises of job and wage creation.

II. THE PROBLEM: CURRENT INDIANA TAX ABATEMENT PROCEDURES DO NOT PROTECT COMMUNITIES FROM EMPTY CORPORATE PROMISES OF JOB AND WAGE CREATION

A. Background

As early as the late 1800's, local municipalities throughout the country have devoted considerable resources to attracting businesses to their communities.²⁴ Businesses and economic development professionals refer to these resources as "packages."²⁵ These packages consist of the various economic development tools that communities use in attracting and retaining industry.²⁶ An economic development package might include incentives such as low-interest financing,²⁷ job training,²⁸ special utility rates,²⁹ or development of new infrastructure.³⁰

THE GREATER ELKHART CHAMBER OF COMMERCE, BUSINESS ASSISTANCE PROGRAMS 4 (1994) (on file with author).

²⁴ Scott Ziance, *Making Economic Development Incentives More Efficient*, 30 URB. LAW. 33, 34 (1998). See generally WILLIAM SCHWEKE ET AL., BIDDING FOR BUSINESS: ARE CITIES AND STATES SELLING THEMSELVES SHORT? (1994) (discussing the costs that cities and states are incurring to attract business investment).

²⁵ Mark Royse M.P.A., *Evaluating an Economic Development Incentive Program: The Case of Tax Abatement in Allen County, Indiana*, 12 ECON. DEV. REV., Fall 1994, at 61. See also Ziance, *supra* note 24, at 33 (stating that communities rely on deals to attract businesses that include such things as job training and even cash). See generally GREG LEROY ET AL., NO MORE CANDY STORE: STATES AND CITIES MAKING JOB SUBSIDIES ACCOUNTABLE 4, 145 (1994).

²⁶ Royse, *supra* note 25, at 61.

²⁷ Some communities offer tax exempt economic development bonds that reduce the cost of financing the construction of a new manufacturing facility. THE GREATER ELKHART CHAMBER OF COMMERCE, ELKHART COUNTY ECONOMIC DEVELOPMENT DATA BOOK 30 (1994) [hereinafter DATA BOOK] (on file with author).

²⁸ The State of Indiana offers manufacturers, distribution centers, and regional headquarters financial assistance in the form of grants and reimbursements of training costs related to new or existing employees. *Id.* This grant program, known as T2000, is administered through the Indiana Department of Commerce and can reduce the training costs of a corporation by up to fifty percent. *Id.*

²⁹ Depending on the size of the project, both the private suppliers of gas and electric as well as the local municipal service providers offer reduced rates on manufacturing consumption. *Id.* See also Ziance, *supra* note 24, at 33.

Of the several economic development tools available to local governments, tax abatement is a common method for attracting corporate investment.³¹ A tax abatement is the decrease of the property tax liability imposed on a corporation's real or personal property.³² In Indiana, tax abatements on real property can be granted for three, six, or ten years, and, since the late 1970's, the state has provided special tax deductions for industrial investment in new equipment and construction.³³

The corporate costs of requesting tax abatement are minimal compared to the potential benefits of receiving an abatement.³⁴ Additionally, many corporations are aware that communities will grant abatements out of fear that a corporation will locate its project elsewhere.³⁵ Consequently, corporate requests for abatement are a

³⁰ Industrial Development Grants are offered through the Indiana Department of Commerce to offset the costs associated with new sanitary sewer lines, railroad spurs, roads, and waterlines. DATA BOOK, *supra* note 27, at 32. These grants are available to existing companies who are expanding, or for the location of a new manufacturing facility. *Id.*

³¹ Ziance, *supra* note 24, at 34. See also J. K. Wilson, *Avoiding Economic Injury: Considerations in the Application of the Economic Development Exemption*, 4 KAN. J.L. & PUB. POL'Y, Winter 1995, at 51, 53-54 (illustrating one circumstance where a city used tax abatements for corporations).

³² BLACK'S LAW DICTIONARY 4 (6th ed. 1990).

³³ Larry Strobel et al., *Hot Issues in Indiana Property Taxation* (Ind. Continuing Legal Educ. F. 1997) [hereinafter Strobel, *Hot Issues*] (on file with author). Although tax abatement is available for some commercial uses, as well as residential development, abatement is primarily used for manufacturing. *Id.* at 26. The number of projects explicitly exempted from consideration for abatement evidences this. See IND. CODE ANN. § 6-1.1-12.1-3(e) (Michie 2000). These exempted projects include golf courses, massage parlors, retail food and beverage services, and other retail facilities. *Id.* Additionally, residential projects only qualify for abatement if they are in a residentially distressed area or a multi-family facility that contains at least twenty percent of the units available for low to moderate-income families. *Id.*

³⁴ General Motors received \$175,000 in personal property tax abatement and \$75,000,000 in real property abatement from the town of Ypsilanti, Michigan. See *infra* notes 115-23 and accompanying text. Additionally, Creative Expressions Group received \$150,000 in abatement. King, *supra* note 2, at 26. In each case, the corporation costs were to follow the administrative procedures outlined by the municipality. See *infra* notes 38-72 and accompanying text. Compared to the financial savings, these costs are minimal.

³⁵ "Recent evidence tends to suggest that incentive bidding tends to feed upon itself, with more expensive items often added at the last minute in an attempt to keep ahead of the competition." JAY KAYNE, National Governor's Ass'n, INVESTING IN AMERICA'S ECONOMIC FUTURE: STATES AND INDUSTRIAL INCENTIVES 14 (1992). See also Mark Taylor, Note, *A Proposal to Prohibit Industrial Relocation Subsidies*, 72 TEX. L. REV. 669 (1994). See also Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 378, 394-95 (1996) ("[B]usinesses have come to expect governmental sweeteners as routine fringe benefits for their siting decisions.").

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common occurrence when a company is seeking to relocate to a new area or expand at an existing site.³⁶ To address this economic reality, the State of Indiana created statutory procedures that govern the process through which a community can grant a corporate request for abatement.³⁷

B. Indiana's Tax Abatement Procedures

1. The Designating Body

In Indiana, the decision to grant a tax abatement is a local matter,³⁸ and both proponents of, and opponents to, tax abatement exist.³⁹ While state laws governing the issuance of tax abatement establish both procedural and substantive guidelines for local communities, these guidelines allow for tremendous flexibility at the local level.⁴⁰ This flexibility is based on a community's understanding of its local economic conditions and the community is in the best position to calculate the advantages and disadvantages of granting a tax abatement.⁴¹ Therefore, local governments administer the process of granting a tax abatement.⁴²

³⁶ In fact, businesses encourage competition between communities to compete against each other in bidding wars to increase the incentives. Andrew L. Kolesar, Note, *Can State and Local Tax Incentives and Other Contributions Stimulate Economic Development*, 44 TAX LAW. 285, 293 (1990).

³⁷ See IND. CODE ANN. § 6-1.1-12.1-4.5 (Michie 2000) (regulating the requirements for the Statement of Benefits, deductions and findings); *Id.* at § 6-1.1-39-1.5 (defining local public improvement and industrial development program); *Id.* at § 6-1.1-39-2 (detailing procedures for designating property an economic development district, which is required before an abatement can be granted); *Id.* at § 6-1.1-39-2.5 (defining procedures for granting a preliminary certification for a proposed abatement); *Id.* at § 6-1.1-39-3 (outlining requirements for notices, hearing, requisites, final actions and appeals); *Id.* at § 6-1.1-39-4 (establishing procedures for appealing a denial of abatement).

³⁸ Municipalities are allowed to use tax abatements at their discretion according to Mike Roeder, Communications Director for the Indiana Association of Cities and Towns. Deanna McCool, *Proposal Backs Labor*, S. BEND TRIB., Oct. 8, 1998.

³⁹ Kirk J. Stark, *Rethinking Statewide Taxation of Nonresidential Property for Public Schools*, 102 YALE L.J. 805 (1992). See also Strobel, *Hot Issues*, *supra* note 33, at 9 (stating that tax abatements are often argued as a "no lose proposition" since the abatement is an incentive to attract new investment); but see Schaefer, *supra* note 20, at 303 (arguing for federal legislation that would restrict states' ability to offer economic incentives to businesses); see generally Errich, *supra* note 35 (proposing that Congress ban the States' use of business incentives through its power derived from the Commerce Clause).

⁴⁰ See, e.g., Wilson, *supra* note 31, at 54. Critics argue that most businesses would have made the same investment whether or not the abatement was given. See *infra* notes 54-62 and accompanying text.

⁴¹ Robert A. Morgan, *Understanding Property Tax Abatement Procedures*, RES GESTAE, Jan. 1997, at 20, 23.

⁴² See *infra* notes 44-72 and accompanying text.

The process through which a company receives a tax abatement is straightforward. Typically, the corporation has pre-qualified the community for reasons other than the intended abatement.⁴³ After this pre-qualification, the company approaches the community representatives who have the power to grant the abatement and informs them of the corporation's desire to invest in that community. These representatives are defined as the "designating body."⁴⁴ At this initial request, the business states its case to the designating body as to why it should be given special tax consideration, and the designating body must then consider the validity of the request.⁴⁵

When the designating body considers granting tax abatement to a corporation, it must estimate the potential advantages of such actions.⁴⁶ These advantages are calculated in terms of wages paid, type and number of jobs created, and the level of diversification to the local economy that a certain project brings.⁴⁷ Additionally, the body will look to the ultimate increase in tax revenue that a project will bring through its capital improvements at a given site.⁴⁸ Assuming that the body decides that a corporation's proposal creates a *prima-facie* case for abatement, the designating body begins the process of abatement by creating an Economic Revitalization Area ("ERA").⁴⁹

⁴³ KAYNE, *supra* note 35, at 29. These factors range from the educational system of the community to a business friendly government that seeks the advice of business and that does not impose undue corporate mandates. *Id.*

⁴⁴ See IND. CODE ANN. § 6-1.1-42-2 (Michie 2000). These rules allow the designating body to tailor the abatements to the needs of the community. *Id.* The designating bodies have the power to set the standards for abatement, limit the time period, type and dollar amount for the abatement. *Id.* The designating body may also impose reasonable conditions for the abatement. *Id.*

⁴⁵ The code that grants the designating body its powers states that the designating body can impose a fee for filing an application that is sufficient to defray any administration costs. IND. CODE ANN. § 6-1.1-42-7 (Michie 2000). Additionally, the designating body may establish general written standards for declaring an area as a zone or granting a deduction under the code. *Id.* If the designating body elects to establish these written guidelines, they must be "reasonably related" to the purposes of tax abatement. *Id.*

⁴⁶ This is conducted by reviewing the corporation's Statement of Benefits and then by conducting a public hearing. IND. CODE ANN. § 6-1.1-42-21 (Michie 2000). See also *infra* notes 73-78 and accompanying text. Interestingly, nothing in the code states that the designating body should consider any disadvantages of a certain project.

⁴⁷ See King, *supra* note 2, at 52.

⁴⁸ *Id.* See also Schaefer, *supra* note 20, at 303.

⁴⁹ IND. CODE ANN. § 6-1.1-12.1-1(1) (Michie 2000). In some instances, the ERA has already been created for the property that the corporation wants to develop upon. See *supra* note 40 and accompanying text.

2. The Economic Revitalization Area

One of the main requirements is that the abatement be given only to a company that invests in what is called an "economic revitalization area."⁵⁰ Although the state legislators intended ERAs to be economically depressed areas of a community, communities granting abatements have interpreted the language liberally⁵¹ and have created ERAs on a project basis as well as for certain geographical areas.⁵² As an example of this liberal interpretation, the City of Wabash, Indiana, declared its entire city limits and any future annexations to be an ERA.⁵³

This frustration of legislative intent to limit abatements to economically distressed areas could be a product of local communities ignoring the spirit of the tax abatement requirement for an ERA.⁵⁴ The

⁵⁰ Strobel, *Hot Issues*, *supra* note 33, at 14. An ERA is defined as follows:

[A]n area which is in the corporate limits of a city, town or county which has become undesirable for, or impossible of, normal development and occupancy because of the lack of development, cessation of growth, deterioration of improvements or character of occupancy, age, obsolescence, substandard buildings, or other factors which have impaired values or prevent a normal development of property or use of property. The term "economic revitalization area" also includes:

(A) Any area where a facility or group of facilities that are technologically, economically, or energy obsolete are located and where the obsolescence may lead to a decline in employment and tax revenues; and
(B) A residentially distressed area, except as otherwise provided in this chapter.

IND. CODE ANN. § 6-1.1-12.1-1(1).

⁵¹ Strobel, *Hot Issues*, *supra* note 33, at 16

⁵² *Id.*

⁵³ In essence, Wabash made the requirement of an Economic Revitalization Area a moot point. In 1993, the City declared its entire city limits and any future annexations an Economic Revitalization Area. The pertinent part of its resolution reads as follows:

Whereas, the Council desires to declare and designate the entire geographic area within the City limits of the City of Wabash, Indiana, as the same now exists and as it may hereafter exist following annexation of additional areas, an Economic Revitalization Area . . .

Wabash, Ind., RESOLUTION 5 (1993) (on file the author).

Additionally, state law allows the local governing body to create the general standards from which an ERA is created. IND. CODE ANN. § 6-1.1-12.1-2(g) (Michie 2000).

⁵⁴ The code states that before creating an ERA or granting an abatement, the designating body shall consider five factors with respect to the proposed project. These factors are:

- 1) Whether the estimate of the value of the redevelopment or rehabilitation is reasonable for projects of that nature.
- 2) Whether the estimate of the number of individuals who will be employed or whose employment will be retained can be reasonably

problems that exist with tax abatement, however, begin at this most basic level, since most states and cities cannot say with any certainty that their communities are receiving any economic benefit from granting these investment incentives.⁵⁵ As of 1993, only half of the states had written guidelines as to what, if any, business incentives should be given at the beginning of a new project.⁵⁶ In fact, many communities in Indiana do not even follow up on the companies that have received tax abatements.⁵⁷

This inability to track the company's progress exacerbates the problems that are inherent in abatement. For example, in granting a tax abatement, the designated body might be creating a real or perceived increased tax burden on those who do not receive the abatement, as well as a precedent of relieving newly located companies from their tax

expected to result from the proposed described redevelopment or rehabilitation.

3) Whether the estimate of annual salaries of those individuals who will be employed or whose employment will be retained can be reasonably expected to result from the proposed described redevelopment or rehabilitation.

4) Whether any other benefits about which information was requested are benefits that can be reasonably expected to result from the proposed described redevelopment or rehabilitation.

5) Whether the totality of benefits is sufficient to justify the deduction.

IND. CODE ANN. § 6-1.1-12.1-3(b) 1-5 (Michie 2000).

Two aspects of this language illustrate both the legislative intent and the ease in which that intent can be frustrated. As to intent, in four of these factors, the code refers to the "described redevelopment or rehabilitation." *Id.* This reinforces the definition of the ERA as an area that is undesirable for normal development. See *supra* note 50. As to the frustration of that intent, the fifth factor allows for a community to grant abatement if it determines that the "totality of benefits" justify the abatement. IND. CODE ANN. § 6-1.1-12.1-3(b)(5). This rather undefined language is what gives rise to the problems inherent with the current abatement procedures. See *infra* notes 58-72 and accompanying text.

⁵⁵ LEROY ET AL., *supra* note 25, at 145. This lack of knowledge is a result of not performing any meaningful cost-benefit analysis or requiring any form of reporting. *Id.*

⁵⁶ Royse, *supra* note 25, at 61. Additionally, many community economic developers lack the time, knowledge and financial backing to create evaluation programs for the abatements that are granted. *Id.* Further, despite the efforts of some states to issue annual reports on tax expenditures, the ability to forecast costs and benefits of a tax abatement are "notoriously open to debate." Enrich, *supra* note 35, at 395-96.

⁵⁷ According to Bill Styring of the Hudson Institute, "A lot of units out there don't police them at all." Ellen Perrone, *Shepard Poorman May Lose Tax Abatement*, INDIANAPOLIS BUS. J., Sept. 16, 1996, at 4. The Hudson Institute is an internationally recognized public policy research organization that forecasts trends and develops solutions for governments, businesses and the public. Hudson Inst., *About Hudson Institute* (visited July 6, 2000) <<http://www.hudson.org/aboutHudson.htm>>.

obligation.⁵⁸ Another potential disadvantage generated by the use of tax abatement is the competition created between two or more Indiana communities to attract a single industry.⁵⁹ Finally, many academics and economic development professionals believe that incentives such as tax abatement encourage development that would have occurred anyway.⁶⁰ Without a sound procedure for estimating the community benefits before the project and no procedure for approximating these benefits after the project, municipalities place themselves in a position of giving nothing more than a welcoming gift to the new company.⁶¹ This problem is the major division between proponents and opponents of tax abatement.⁶²

Proponents of tax abatement liken these types of subsidies to investments, and those opposed to abatements liken them to gifts.⁶³ Both

⁵⁸ *Creative*, *supra* note 2, at 54. These costs, however, are difficult to calculate and decision makers tend to minimize the costs and maximize the benefits, since the "political" costs of failing to provide investment incentives are greater than aggressively competing in a bidding war. Enrich, *supra* note 35, at 395-96. See also Taylor, *supra* note 35, at 693-94.

⁵⁹ See Jennifer L. Gilbert, *Selling the City without Selling Out: New Legislation on Development Incentives Emphasizes Accountability*, 27 URB. LAW. 427, 434 (1995). Researchers agree that firms take into consideration three main factors when relocating a facility. *Id.* First, a company looks to a major geographic location as defined by its marketing or management strategy. *Id.* Second, a firm considers a community that can meet specific needs such as close proximity to suppliers. *Id.* Finally, the corporation considers subjective factors of specific communities. *Id.* In these cases, incentives only act as a tiebreaker between two communities of the same region. *Id.* Unless communities have a coordinated effort, competition between cities for industry can waste scarce public resources. JEFFREY S. LUKE ET AL., *MANAGING ECONOMIC DEVELOPMENT: A GUIDE TO STATE AND LOCAL LEADERSHIP STRATEGIES* 60 (1988). One example of this regional cooperation is the effort by the Cities of Eugene and Springfield, Oregon. *Id.* These cities coordinated the efforts of their respective Chambers of Commerce and created a second organization known as the Business Assistance Network Group ("BANG"). *Id.* at 61. Through these entities, the regional area leveraged their resources for recruiting industries to the local area. *Id.* at 60-61. This type of cooperative effort can significantly reduce the competition and increase efficiency in development activities. *Id.* at 61.

⁶⁰ Matthew T. Furton, *The Use of Penalty Clauses in Location Incentives Agreements*, 70 IND. L. J. 1009, 1015 (1995). See also Jack Lyne, *Incentives Are Important, Executives Say, But Business Concerns Drive the Location Process*, SITE SELECTION, Apr. 1992, at 282, 283 (reporting that only three percent of the corporate real estate executives surveyed would be motivated by a major incentive package and that most of their location decisions are based on established business considerations).

⁶¹ See *infra* notes 84-95 and accompanying text. These are just a few of the many examples of communities who ultimately grant tax abatement, only to be left empty handed.

⁶² Royse, *supra* note 25, at 61.

⁶³ JAY KAYNE & MOLLY SHONKA, *RETHINKING STATE DEVELOPMENT POLICIES AND PROGRAMS* 13 (1994); see also Royse, *supra* note 25, at 61 (stating that economic development decisions are a matter of public policy and should be debated on the facts and not from an emotional response).

those in favor of, and those opposed to, tax abatements have the potential of being correct as to the value of abatement, depending on the expectation of the community.⁶⁴ If the community believes that it will gain a net increase in wealth, the subsidy should be determined to be an investment.⁶⁵ The purpose of economic development is to increase jobs, income, and revenues, abatements can correctly be considered investments.⁶⁶ Communities, however, need not expect any return on their investment to grant tax abatement.⁶⁷ Regardless of whether the community expects any benefit from the abatement, the corporation clearly knows the benefits it will receive, as well as the minor costs it will accrue, in requesting the abatement.

3. The Tax Abatement

While the community may not know what to expect from an abatement, the benefits to the company are easily calculated. These benefits are based on statutory formulae for reducing the corporation's tax burden.⁶⁸ This reduction of corporate tax liability is a product of the increased assessed value⁶⁹ created by the new corporate investment and the percentage of reduction allowed by the statute.⁷⁰

As an example, if the company improves the assessed value of the property such that the tax revenue from that property increases by

⁶⁴ KAYNE & SHONKA, *supra* note 63, at 13.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ The South Bend City Council unanimously approved a tax abatement for a 37-acre plot of land. *Panel OKs Abatement for Industrial Park*, S. BEND TRIB., Mar. 13, 1998, at C2. The City's rationale was that it should encourage efforts to attract good-paying jobs. *Id.*

⁶⁸ See IND. CODE ANN. § 6-1.1-42-28 (Michie 2000). The Indiana Code creates three timetables for granting abatement:

| | Three Year Abatement | Six Year Abatement | Ten Year Abatement |
|------------------|----------------------|--------------------|--------------------|
| Year | | | |
| 1 st | 100% | 100% | 100% |
| 2 nd | 66% | 85% | 95% |
| 3 rd | 33% | 66% | 80% |
| 4 th | | 50% | 65% |
| 5 th | | 34% | 50% |
| 6 th | | 17% | 40% |
| 7 th | | | 30% |
| 8 th | | | 20% |
| 9 th | | | 10% |
| 10 th | | | 5% |

Id.

⁶⁹ For further analysis of assessed value, see *infra* notes 138-42 and accompanying text.

⁷⁰ IND. CODE ANN. § 6-1.1-42-28.

\$100,000, with a three-year abatement, the company will save \$199,999 in taxes over the three-year period.⁷¹ Once the company has made the investment, the only burden left for receiving the abatement is to file a certified deduction application.⁷² Consequently, a corporation will know the value of an abatement before going ahead with a project. The community, however, is not in the same position.

A community's lack of knowledge as to what its benefits will be in granting a corporate request for abatement is directly attributable to the lack of corporate accountability that exists in Indiana's tax abatement procedures. Nowhere is this lack of accountability more evident than the Indiana requirement of a corporate Statement of Benefits. Communities must base their decisions to grant an abatement on this Statement of Benefits, and it is from this Statement of Benefits that communities are being denied an accurate assessment of any potential benefit they might receive from granting an abatement.

III. THE STATEMENT OF BENEFITS: WHEN A PROMISE IS NOT A PROMISE

A main component of an abatement request is the "Statement of Benefits."⁷³ In this Statement of Benefits, the company must include a description of how it plans to redevelop or rehabilitate the property,⁷⁴ as well as the number, and estimated salaries, of new or retained jobs it will provide.⁷⁵ After the company submits its request for tax abatement, the community's designated body must review the Statement to determine if the projected community benefits seem to be "reasonable" for the size and type of project that is under consideration.⁷⁶ The community's designating body looks at the totality of the benefits to determine if it is sufficient to justify the deduction.⁷⁷ Only after it has been determined that the project's stated community benefits justify the deduction, can

⁷¹ Using the formula for a three year abatement, the company saves \$199,999. See *supra* note 68 and accompanying text.

⁷² The certified deduction application has many component parts that require the company to provide information such as the value of the property before rehabilitation, and the value after rehabilitation. IND. CODE ANN. § 6-1.1-42-27(c) (Michie 2000).

⁷³ An applicant must provide a Statement of Benefits to the designating body. IND. CODE ANN. § 6-1.1-12.1-3(a) (Michie 2000). This Statement of Benefits must include a description of the rehabilitation or redevelopment, an estimated value of the redevelopment, and of the created or retained jobs with salary estimates. *Id.*

⁷⁴ This language reinforces the idea that the legislature intended that tax abatement be used to revitalize economically depressed areas.

⁷⁵ IND. CODE ANN. § 6-1.1-12.1-3(a) (1998).

⁷⁶ IND. CODE ANN. § 6-1.1-12.1-4.5 (Michie 2000).

⁷⁷ *Id.*

the abatement be approved.⁷⁸ It is from this Statement of Benefits that most of the problems with tax abatement begin.

A. Lack of Corporate Accountability for Wage and Job Creation

One of the disadvantages of the current Statement of Benefits is the lack of accountability with respect to the actual benefits. For example, in analyzing the impact of a particular project, many communities base their benefits on unrealistic or overly optimistic assumptions of the jobs that will be created.⁷⁹ The number of jobs created is the primary factor that most communities use in determining the impact of a new corporate investment.⁸⁰ These jobs fall into the two main categories of actual jobs,⁸¹ and those jobs created by the "ripple effect."⁸² Too often, the difference between the assumed job creation before the abatement and the actual job creation once the abatement is granted significantly reduces the value of the project to the community.⁸³ This fact occurs in both the actual jobs associated with the project and those jobs created by the "ripple effect."

1. Failure to Perform in Creating Actual Jobs

Many times, a corporation fails to create the number of jobs it promises to create when it requested its abatement.⁸⁴ An example of this problem is the tax abatement that was granted to the Shepard Poorman company, a commercial printer, for its investment into the Indianapolis area.⁸⁵ Marion County forgave \$470,000 in personal property tax based

⁷⁸ IND. CODE ANN. § 6-1.1-39-3 (Michie 2000).

⁷⁹ LEROY ET AL., *supra* note 25, at 7. See also Enrich, *supra* note 35.

⁸⁰ See U.S. CHAMBER OF COMMERCE, WHAT 100 NEW JOBS MEAN TO A COMMUNITY 5-6 (1985) [hereinafter, 100 NEW JOBS].

⁸¹ In addition to the actual jobs that are created, the 1984 study by the U.S. Chamber of Commerce indicated that for every one hundred new jobs a community gains, that community can expect to see an increase in aggregate personal income of \$1,948,353, an increase in population of 202 people, and seven new retail establishments. *Id.* at 6.

⁸² The 1984 study by the U.S. Chamber of Commerce also concluded that a community that can attract or retain one hundred new manufacturing jobs would create or retain sixty-four non-manufacturing jobs. *Id.* at 7. This study divided these jobs into several sub-categories as follows: Forty-five new jobs in wholesale/retail, seven new positions in transportation, and three additional positions in each area of finance, business services, construction and public administration. *Id.* See also LEROY ET AL., *supra* note 25, at 145. The rule that governs the expected benefits is that the larger the dependence on this multiplier effect, the smaller the accuracy is in determining a project's future benefits. *Id.*

⁸³ See *infra* notes 103-06 and accompanying text.

⁸⁴ See *infra* notes 102-06 and 115-23 and accompanying text for further examples.

⁸⁵ See Perrone, *supra* note 57, at 4. Although the Shepard Poorman abatement was granted on personal property, it is a good example of the problems in projecting job creation since it

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on Shepard Poorman's commitment to retain 502 employees, create twenty-five new positions, and invest more than \$11.3 million in new equipment.⁸⁶ One year after receiving the abatement, Shepard Poorman's workforce actually declined by seventeen percent and the company returned a multi-million dollar piece of equipment that it used to qualify it for the abatement.⁸⁷ According to Shepard Poorman's president, Robert W. Poorman Jr., the decrease in his company's employment was a result of weak commercial print demand and slower than expected growth.⁸⁸ The ultimate result was that Marion County could not recover the tax revenue that would have been generated during the period in which the company received an abatement.

Under current Indiana tax abatement policies, a corporation may receive an abatement without a promise of job creating. The City of South Bend's unanimous preliminary approval of an abatement for a new downtown restaurant best illustrates this situation.⁸⁹ In requesting a six-year property tax abatement, Ultimate Connections, Inc. presented the three phases of its anticipated business growth to the South Bend City Council.⁹⁰ In Phase One, Ultimate Connections would provide specialty and flavored coffees while allowing its patrons to surf the Internet.⁹¹ Phase Two consisted of creating an area for "high speed gaming," where people sit and play computer games with other people from around the world.⁹² If these first two phases were successful, Ultimate Connection planned to invest \$50,000 in a full-service restaurant.⁹³

Without debating the economic value of people drinking coffee or playing computer games, the telling point of this project is that renovations on the property had already begun.⁹⁴ Consequently,

illustrates another problem with forecasting new jobs, which is the impact the economy at large has on industrial growth. *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ See Terrence Bland, *Cyber Café to Move in Downtown- New Restaurant May Open Soon at Former Senor Kelly's*, S. BEND TRIB., Sept. 15, 1998, at B1.

⁹⁰ *Id.* South Bend is a retail center for the region with a total market penetration of sixteen counties; sales average over five billion dollars per year. CITIES, *supra* note 5, at 85.

⁹¹ Bland, *supra* note 89, at B1.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.* Another interesting aspect of this particular project is that the property was owned by one of the city council members, and a second councilman was the real estate agent for the property. *Id.* This is not to say that South Bend should not encourage the expansion of

Ultimate Connections had committed to the investment in the property, and the jobs would have been created without the abatement. This made the abatement nothing more than a gift, and not an investment.⁹⁵ Nevertheless, the lack of corporate accountability for creating actual jobs pales in comparison to a community's inability to depend on jobs supposedly created by what is called the "ripple effect."

2. A Project's Economic Impact Created by the Multiplier Effect

The "ripple effect," also known as the "multiplier effect," is the secondary economic activity that occurs as a result of a given project.⁹⁶ For example, the new employees of the corporation will increase demand for additional local services such as housing, food, and entertainment, resulting in increased economic activity.⁹⁷

In general, as the percentage of a project's expected benefits derived from secondary economic activity increases, the accuracy of a community's estimate of the project's total benefits will decrease.⁹⁸ This occurs because the multiplier effect relies on numerous, difficult to quantify, factors.⁹⁹ For example, the larger the area that a community estimates will be effected by a project, the greater the community's estimate of the project's impact will be.¹⁰⁰ If a community makes erroneous assumptions as to the geographic "reach" of the project, or the project's impact on the in-state production and sale of other goods and services, the actual impact of the project can vary widely from the community's initial expectations.¹⁰¹

Attempts have been made to increase this multiplier effect by mandating that developers use local contractors in the development of the project.¹⁰² Similarly, some communities have required that the

its service sector. From 1990 to 1995, Saint Joseph County experienced a nearly ten percent increase in the number of service establishments. *FACT BOOK*, *supra* note 4, at 337.

⁹⁵ See *supra* notes 63-67 and accompanying text.

⁹⁶ Kolesar, *supra* note 36, at 301.

⁹⁷ See 100 NEW JOBS, *supra* note 80, at 7.

⁹⁸ Kolesar, *supra* note 36, at 301.

⁹⁹ *Id.* at 302.

¹⁰⁰ As the definition of what constitutes a "local" economy grows, the multiplier effect grows as well. *Id.* Other factors that affect the multiplier effect are the community's proximity to other states, and the types of services provided to and by the new company. *Id.*

¹⁰¹ *Id.*

¹⁰² Deanna McCool, *Proposal Backs Labor*, S. BEND TRIB., Oct. 11, 1998. Mishawaka City Council President Steve Emmons proposed a city ordinance that required a company to use St. Joseph County contractors if it is granted a tax abatement. *Id.* Emmons stated that "If

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company receiving the tax abatement hire a certain number of local employees.¹⁰³ However, this type of requirement is difficult to enforce, and communities many times receive less than what they bargained for.

One example of a community receiving fewer jobs than it had bargained for is Hammond.¹⁰⁴ In exchange for \$15,000,000 in tax relief, sixteen firms promised to create approximately 804 jobs.¹⁰⁵ Upon investigation, the community found that none of the firms had met its projected goals and that five had in fact lost 101 jobs.¹⁰⁶ These examples illustrate the problems facing a community when a corporation fails to fulfill its promises.

B. The Problems Left to a Community When a Company Fails to Perform

Communities face several problems in recovering any forgiven tax revenue from a company when its actual performance does not meet or exceed its projected performance. Nationally, several recommendations have been made to solve these problems.¹⁰⁷ Suggested solutions include claw back provisions,¹⁰⁸ federal legislation banning tax abatements,¹⁰⁹ or guaranteeing job quality standards.¹¹⁰

Each of these solutions has inherent problems that make their implementation unrealistic. Clawbacks, a method for recovering the abated tax revenue, serve no purpose in the cases where the company

we're going to give tax dollars away locally, we want to make sure the money is spent here." *Id.*

¹⁰³ *Id.*

¹⁰⁴ See Chris Isidore, *Few Jobs in Return for Tax Breaks - No Hammond Firm Met Hiring Goals*, GARY POST TRIB., Feb. 2, 1990, at B5.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ See Schaefer, *supra* note 20, at 304 (advocating federal legislation banning corporate subsidies); Kolesar, *supra* note 36, at 285-86 (questioning the value of tax incentives as a method for stimulating economic growth); Taylor, *supra* note 35 (proposing the prohibition of local business incentives).

¹⁰⁸ Furton, *supra* note 60, at 1015. Clawbacks allow the municipality to recover all or part of past subsidy expenditures. KAYNE, *supra* note 35, at 29.

¹⁰⁹ Enrich, *supra* note 35, at 396. See also Schaefer, *supra* note 20, at 303.

¹¹⁰ See Gilbert, *supra* note 59, at 434. In 1992, Oklahoma's Governor David Walters requested that Oklahoma's Department of Commerce conduct a review of private sector involvement in the state and how this involvement related to the state's incentive packages for industry. *Id.* In answering this request, the department produced a report that suggested four changes in the state's economic development practices. *Id.* Two of these changes related directly to job quality of the state's industry. *Id.*

has become insolvent.¹¹¹ Additionally, the cost of enforcing such provisions may be prohibitive for some municipalities.¹¹² As to federal legislation, political support for it does not exist and, if enacted, such legislation could be more costly than beneficial to enforce.¹¹³ As for the guarantee of job quality, the example of the Creative Expressions Group from the beginning of this Note illustrates the futility of this remedy,¹¹⁴ as does the case of *Charter Township of Ypsilanti Michigan v. General Motors Corp.*¹¹⁵

In 1997, the township of Ypsilanti, Michigan created an industrial development district (Michigan's equivalent to Indiana's Economic Revitalization Area) to encourage the creation and retention of jobs.¹¹⁶ In 1984 and in 1988, the township granted General Motors' request for abatement of taxes on approximately \$175,000,000 of personal property and \$75,000,000 on real property.¹¹⁷ These abatements were to last for twelve years and were equivalent to fifty percent of the taxes owed.¹¹⁸ In 1991, General Motors announced the closure of its facilities in Ypsilanti due to record losses and less than projected sales of the Caprice automobile.¹¹⁹

¹¹¹ Insolvency is when the corporation is unable to pay its debts. PEARCE, *supra* note 23, at 208.

¹¹² Ziance, *supra* note 24, at 44-45.

¹¹³ Schaefer, *supra* note 20, at 336. While Schaefer is in support of federal legislative action on this matter, he acknowledges that it is "likely to be difficult to pass in the current political climate" *Id.* Additionally, the cost of creating a federal bureaucracy would be substantial in both actual dollars and delay. Taylor, *supra* note 35, at 706-07.

¹¹⁴ See *supra* note 2.

¹¹⁵ *Charter Township of Ypsilanti v. General Motors Corp.*, 506 N.W.2d 556 (Mich. Ct. App. 1993). Ypsilanti Township unsuccessfully sued General Motors (GM) under a theory of promissory estoppel when GM relocated a production plant from the township to Arlington, Texas. *Id.* at 559.

¹¹⁶ *Id.* at 557-58. The Michigan regulations governing Industrial Development Districts require the municipality to determine that not less than fifty percent of the property that is to be in the district be "obsolete". MICH. COMP. LAWS. ANN. § 207.554(5) (West 1998). This restriction is not placed on Indiana municipalities as illustrated by the City of Wabash. See *supra* note 38 and accompanying text.

¹¹⁷ *Charter Township of Ypsilanti*, 506 N.W.2d at 558. In the meeting before the Ypsilanti Township Board of Trustees (Ypsilanti's agency to approve abatements), the Washtenaw County Commission Chairman nearly predicted the ultimate dispute between Ypsilanti and General Motors. The chairman stated that GM had not made any commitments. *Id.* at 561. Additionally, the chairman said, "Who knows, they might move tomorrow or two years from now and they will have been given three tax breaks with a hidden plan." *Id.*

¹¹⁸ *Id.* at 558.

¹¹⁹ *Id.* General Motors claimed that the closing of the Ypsilanti plant was a corporate necessity, since it was experiencing record losses due to the lack of sales for the Caprice. *Id.*

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The township of Ypsilanti sued General Motors under both a breach of contract theory as well as a promissory estoppel theory to recover the tax revenue that had been abated.¹²⁰ After the trial court found in favor of Ypsilanti on the theory of promissory estoppel, the Michigan Court of Appeals overturned the decision stating that any statements made by General Motors in the negotiation of the tax abatements were nothing more than "hyperbole," or "puffery."¹²¹ The court stated that "the mere fact that a corporation solicits a tax abatement and persuades a municipality with the assurances of jobs cannot be evidence of a promise."¹²² Consequently, after the relationship was over, General Motors received millions of dollars in tax relief, and Ypsilanti was left with 4,500 unemployed workers and their families.¹²³

As the above examples illustrate, when a community grants an abatement based on corporate promises of future job creation, the community has granted that abatement based on speculation. More importantly, however, when the company fails to perform, the community is left with little recourse. One solution is for communities to base their decisions to grant an abatement on a quantifiable factor that is itself a benefit to the community. This factor, an increase in tax revenue, can be identified when a community conducts a cost-benefit analysis prior to the granting of the abatement.

IV. THE COST-BENEFIT SOLUTION

The facts "relating to a community's investment in a new project are inherently speculative."¹²⁴ One solution to reduce the impact of these speculative factors is for a community that is deciding to invest in a project to use a simple cost-benefit formula that is dependent on only

GM had originally projected its sales of the Caprice at 330,000 annually; yet actual sales had slipped below 100,000 in 1991. *Id.*

¹²⁰ *Id.* at 559.

¹²¹ *Id.* The trial court concluded that it would be a gross inequity to allow General Motors to lull the community into giving up millions of dollars that could have been used for education or basic government needs and then desert 4,500 workers and their families. *Id.* at 558.

¹²² *Charter Township of Ypsilanti*, 506 N.W.2d at 559.

¹²³ *Id.* at 558.

¹²⁴ Kolesar, *supra* note 36, at 301. These speculative factors include the private investment in the project, the value of the goods produced, the cost of labor, and the cost of utilities. *Id.* As an example, Pennsylvania overestimated the life of a Volkswagen plant causing the state to grossly overestimate its ability to recoup its investment. *Id.*

three quantifiable variables.¹²⁵ These variables are: the tax revenue generated by the subject property prior to the corporate investment;¹²⁶ the tax revenue generated by the subject property after the corporate investment;¹²⁷ and the community's costs in providing services to the subject property during the abatement.¹²⁸ By basing its decision on these concrete factors, a community avoids the dilemma of deciding whether the company has performed on its promises as outlined in its Statement of Benefits.

A. Cost-benefit Formula

One of the fundamental difficulties facing any policymaker, such as members of a local designating body, is determining whether their decisions have been in the public interest.¹²⁹ The idea of measuring the net advantages of a capital investment in terms of society's net utility gains originated in 1884.¹³⁰ Although the idea of measuring the society's gains from a project began in the nineteenth century, the practical application of this theory on public investments had its beginnings in the 1950s in the form of cost-benefit analysis.¹³¹ Although the use of cost-benefit analysis has been criticized as impractical in certain circumstances,¹³² the use of a cost-benefit analysis in determining the

¹²⁵ These variables are currently used by communities in deciding to grant tax abatement and by the county or township assessors in determining the value of the abatement for the corporation. See *infra* notes 139-42 and accompanying text. Consequently, no additional cost will occur in gathering this information.

¹²⁶ See *infra* notes 138-48 and accompanying text.

¹²⁷ See *infra* notes 138-48 and accompanying text.

¹²⁸ See *infra* notes 149-55 and accompanying text.

¹²⁹ See LEE G. ANDERSON & RUSSELL F. SETTLE, *BENEFIT-COST ANALYSIS: A PRACTICAL GUIDE* 1 (1977). Many times the local politicians will grant an abatement to a company for fear that if the company decides not to locate in the community, the politician will be labeled as anti-business. See Enrich, *supra* note 35.

¹³⁰ AJIT K. DASGUPTA & D.W. PEARCE, *COST - BENEFIT ANALYSIS: THEORY AND PRACTICE* 11 (1972). A well-known paper written by J. Dupuit pointed out that "political economy has not yet defined in any precise manner the conditions which these [public] works must fulfil (sic) in order to be really useful." *Id.*

¹³¹ In a 1950 report by the Federal Inter-Agency River Basin Committee's Sub-committee on benefits, an attempt was made to formalize the procedures for valuing costs and benefits. *Id.* at 12. This report was notable for using the cost-benefit language and for merging the practical project analysis with welfare economics. *Id.*

¹³² See, John Carey & Mary Beth Regan, *Are Regulations Bleeding the Economy*, BUS. WK., July 17, 1995, at 75. These criticisms are based on the fact that in some areas of the law, neither the costs nor the benefits can be accurately calculated. *Id.* Dale Hattis, an economist from Clark University, stated that "[t]he lesson from doing this kind of [cost-benefit analysis] is that it is kind of hard to get right. It's so hard, in fact, that estimates of costs and benefits may vary by factors of a hundred or even a thousand." *Id.*

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value of a new industrial project to a community is not novel.¹³³ In fact, some could argue that the current Statement of Benefits is required so that communities know the benefits associated with the costs of a certain project.¹³⁴ Yet, as demonstrated by the above examples, communities are in no position to determine from the Statement of Benefits the likelihood of those benefits materializing.¹³⁵ In addition, these communities are not in a position of enforcing these promises when it is evident that the company has not met its obligations.

By basing its decision on a comparison of its up-front and continual costs to the increased revenue generated by the corporate investment, the community will be able to determine in concrete terms the actual return on its investment.¹³⁶ Since both the increased revenue and the community costs are not as subjective as the other traditional benefits of "quality jobs," "diversification of the local economy," or the number of

¹³³ In 1968, the country of Greece began developing what is now a complex, yet effective, cost-benefit formula for determining the impact that a new industrial development will have on the economy. See Nikolaos Vagionis, *The Cost-Benefit Appraisal of Industrial Areas Programme in Greece: Aims Methodologies and Assumption*, EUR. PLAN. STUD. 16 (1994). The cost-benefit model used by Greece takes into account many of the same variables that Indiana's Statement of Benefits addresses. *Id.* These include the quality of jobs, the multiplier effect, and land costs. *Id.* The Grecian model, however, has the benefit of thirty years of development and national support. *Id.* These two advantages are not available to smaller communities such as Bippus or Red Key in Indiana. Additionally, the overall aim of the Grecian program is "regional" development. *Id.* at 17. This focus on regional development is also lacking for many of Indiana's communities.

¹³⁴ Cost-benefit analysis has been defined as a conceptual framework for the evaluation of investment projects in both the government and private sectors. See PEARCE, *supra* note 23, at 83. Cost-benefit analysis differs from a straightforward financial appraisal in that it considers all gains (benefits) and losses (costs) regardless as to when they occur. *Id.* The Statement of Benefits allows the community to estimate the future benefits of a particular project and compare them to the costs associated with the project. See *supra* notes 73-76 and accompanying text. In a typical cost-benefit model, the community should consider all costs and benefits regardless of when they occur. PEARCE, *supra* note 23, at 83. Future costs and benefits are considered at a "discount rate" since these costs or benefits might not occur. *Id.* Many cost-benefit practitioners, however, tend to ignore future factors and assign to them a discount rate of zero. *Id.* In essence, by only considering the increased assessed value of a particular project, a community would be assigning a discount rate of zero to the company's promises outlined in the Statement of Benefits.

¹³⁵ See *supra* notes 84-123 and accompanying text.

¹³⁶ This solution would also allow states to develop incentive policies and procedures upon which all future incentive negotiations are based. See KAYNE, *supra* note 35, at 14. Although Kayne does not specifically advise this method of determining whether a project is proper for a community, he does advocate a uniform policy upon which economic development incentives should be based. See generally *id.*

jobs created or retained, the community can make a reasonable decision as to whether an abatement is a prudent investment.¹³⁷

B. Identifying the Factors for the Cost-benefit Formula

The least troublesome variable in this cost-benefit analysis is the current tax revenue that the municipality is receiving from the subject property, since every community has access to the information regarding its revenues generated from a given piece of real estate.¹³⁸ This revenue information is readily available at the township assessor's office and is a function of the township's property tax rate and the assessed value of the given property.¹³⁹ From this accurate register of the community's current revenue stream from the subject property, the community has the benchmark from which it can analyze any proposed improvements.¹⁴⁰

With the current Statement of Benefits, the company requesting a tax abatement is compelled by the designating body to provide information as to the type, cost and design of the improvement.¹⁴¹ Consequently, requiring a corporation to provide this information for a cost-benefit analysis would not impose any additional burdens on the corporation. From this information, the designating body would be able to calculate the increased revenue created by the company's investment in the project.¹⁴² This increased revenue would be reflected in what Indiana calls the "true value" of the property.¹⁴³

¹³⁷ See *infra* notes 140-42 and accompanying text.

¹³⁸ IND. ADMIN. CODE tit. 50, r. 2.2-2-4 (1996) (stating that the assessor of the township in which the property is located is responsible for appraising the property or having it appraised). "The township assessor or the authorized representative, may enter and fully examine all buildings and structures in order to determine the assessed value." *Id.* at 4(c).

¹³⁹ *Id.* at 4(b). "The township assessor shall keep the reassessment data and records current by securing the necessary field data and making changes in the assessed value of the real property as changes occur in its use." *Id.*

¹⁴⁰ Before a community can know what to expect from a project, it should be aware of what it currently is receiving from the property.

¹⁴¹ See *supra* note 75 and accompanying text.

¹⁴² The county assessors are responsible for the records of the current tax revenues for the property as well as the valuation of any improvements on the property. IND. ADMIN. CODE tit. 50, § 2.2-2-6(a) (1996). Since the cost of the proposed new construction will be equivalent to the replacement costs of that new construction, the community can obtain from the county or township assessor a fairly accurate estimation as to the increased tax revenue created by the proposed corporate investment.

¹⁴³ Tax rates are applied to a figure known as the "assessed value," which is equal to thirty-three and one third percent of the true-tax-value. Larry Strobel, *Critique of the Indiana True Tax Value Assessment System*, in INDIANA REAL PROPERTY TAX ASSESSMENTS 2 (Legal

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As an example, if the company's proposed project will increase the true-tax-value of the property by \$3,000,000 and the community has a ten percent net tax rate¹⁴⁴ on the proposed property, that community will receive an increase in tax revenue from that property of \$100,000 a year without the abatement.¹⁴⁵ The advantage of basing an abatement decision on the increased true-tax-value of the property is that, for a specific property, the true-tax-value is an objective measurement.¹⁴⁶ This objectivity is a result of the fact that the same tax assessor evaluates the property before and after the corporate investment.¹⁴⁷ Consequently, by tying the abatement to the increase in tax revenue created by the corporate investment, the designating body has two quantifiable factors upon which it can base its abatement decision: the pre-corporate investment tax revenue and the post-corporate investment tax revenue.

The difference in the tax revenue between the pre-corporate investment and the post-corporate investment would be the return that

Education Forum 1993) [hereinafter Strobel, *Critique*] (on file with author). See also IND. CODE ANN. § 6-1.1-1-3 (Michie 2000). "With respect to the assessment of real property, true tax value does not mean fair market value. True tax value is the value determined under the rules of the state board of tax commissioners." IND. CODE ANN. § 6-1.1-31-6(c) (Michie 2000).

Indiana is one of two states that does not use a fair market value approach to real property valuation for taxation purposes. Ernest J. Szarwark, *Tax Court Finds Valuation Methodology Unconstitutional*, 40 RES GESTAE 25 (July 1996). True-tax-value is based on hypothetical replacement costs of the structure and can consider such things as obsolescence and age of the structure. *Id.* The true-tax-valuation of property is extremely controversial and has recently been challenged as unconstitutional. See also Rosalie Berger Levinson, *State and Federal Constitutional Law Developments*, 30 IND. L. REV. 965, 974-75 (1998) (describing the Indiana Supreme Court's decision which upheld the true-tax-value system).

¹⁴⁴ To determine the net tax rate, a municipality divides its budget for the following year into the property tax base to obtain its tax rate. Ronald d' Avis, *Evaluating Real Property Tax Assessments*, in INDIANA REAL PROPERTY TAX ASSESSMENTS 2 (Ind. Continuing Legal Educ. F. 1993). For example:

A taxing district has an approved budget of \$15 million and a total tax base of \$215 million. The tax rate is \$15 million divided by \$215 million or 6.9767%. If a taxpayer's home has an assessed value of \$30,000, the taxpayer's taxes will be \$2,093 (\$30,000 X .069797). Various exemptions and deductions may reduce this gross tax amount.

Id.

¹⁴⁵ If the property value is increased by \$3,000,000, then the increase in the assessed value is \$1,000,000 (\$3,000,000 X 33 1/3% = \$1,000,000). By multiplying the assessed value by the township's net tax rate of ten percent, the increased revenue to the municipality is \$100,000 (\$1,000,000 X 10% = \$100,000).

¹⁴⁶ While controversy surrounds the true-tax-value system, this value is calculated by the mechanical rules found in the *Indiana Real Property Assessment Manual*. Strobel, *Critique*, *supra* note 143, at 3.

¹⁴⁷ See *supra* note 143.

the community receives from granting the abatement.¹⁴⁸ The costs incurred by the community in providing services to the corporation during the time of abatement are the community's investment in the subject property.¹⁴⁹ The costs associated with tax abatement can be divided into two major categories: the actual costs associated in providing services to the proposed project¹⁵⁰ and the loss of tax revenue resulting from the abatement.¹⁵¹ Since the lost tax revenue resulting from abatements is the subject of debate,¹⁵² communities should base their decisions on the actual costs associated with the proposed development. The actual costs are primarily associated with infrastructure improvements, such as roads, curbs, water, and sewer.¹⁵³ By calculating these costs, the community is in a position, before the granting of the abatement, to make a calculated estimate of the costs associated with it.¹⁵⁴

Once the community has ascertained the costs associated with the new project, it can then compare these costs to the increased revenue

¹⁴⁸ Return is defined as the reward for investing. JAE K. SHIM, PH.D. & JOEL G. SIEGEL, *DICTIONARY OF ECONOMICS* 299 (1995). In the case of the community receiving tax revenue, this return is in the form of current income since it consists of periodic cash payments. *Id.*

¹⁴⁹ Investment is defined as "the flow of expenditures devoted to projects producing goods which are not intended for immediate consumption. PEARCE, *supra* note 23, at 219.

¹⁵⁰ Schaefer, *supra* note 20, at 324.

¹⁵¹ Many commentators consider tax incentives to be an unnecessary depletion of government revenue sources that erodes government services, such as infrastructure and educational services. Kolesar, *supra* note 36, at 300.

¹⁵² See *supra* note 62 and accompanying text.

¹⁵³ Infrastructure is the physical public works framework that supports and sustains all economic activity. LUKE, *supra* note 59, at 215. Infrastructure typically includes highways, roads, water and electric utilities. *Id.* These types of costs, however, can provide a significant inducement to development and provide for a higher level of economic health and competitiveness as well as a higher quality of life. *Id.* at 216

¹⁵⁴ Several methods exist for estimating the community costs involved in a proposed corporate venture. Wilson, *supra* note 31, at 55. These methods include the Per Capita Multiplier Method, the Case Study Method and the Proportional Valuation Method. *Id.* The Per Capita Multiplier Method is a cost effective and accurate method for communities with populations of between 10,000 and 50,000. ROBERT W. BURCHELL ET AL., *THE NEW PRACTITIONER'S GUIDE TO FISCAL IMPACT ANALYSIS* 9 (1985). This method considers the demographics of the community, such as housing and population. *Id.* at 10. The Case Study Method is a highly detailed analysis that uses interviews of local officials to gather information concerning the capacity of the local services. ROBERT W. BURCHELL & DAVID LISTOKIN, *THE FISCAL IMPACT HANDBOOK* 45-52 (1983). The advantage of this method is that the community can receive a more accurate projection of its costs relative to its existing capacity. *Id.* The Proportional Valuation Method allocates a proportional share of the municipality's costs to the proposed project. *Id.* at 119. This proportional share is derived by assigning the total municipal cost to all non-residential property and has the advantage of being relatively quick and inexpensive. *Id.*

generated from the project and determine whether the increase in revenue justifies the abatement. Using the projected increase in tax revenue, the designating body is in a position to calculate the rate of return on its investment in the development project.¹⁵⁵ After calculating this rate of return, the question then becomes whether that rate of return is reasonable.

C. Determining What Constitutes a Reasonable Rate of Return

The state legislature could determine what constitutes a reasonable rate of return. Although it is within the legislature's power to arbitrarily set the standard for a reasonable rate of return, the legislature could set the standard rate of return as greater than or equal to the federal discount rate.¹⁵⁶ By comparing the community's expected rate of return to the discount rate, the community receives at least two advantages.

First, the discount rate provides for an objective standard and is easily obtainable.¹⁵⁷ More important, however, is the fact that the prime rate fluctuates with the national economy.¹⁵⁸ As the national economy slows down, the Federal Reserve lowers interest rates.¹⁵⁹ Consequently,

¹⁵⁵ Rate of return is defined as a general concept referring to the earnings from an investment of capital. PEARCE, *supra* note 23, at 363. In the case of infrastructure improvements, the community's commitment of its tax dollars to the project is its financial capital. *Id.* at 79. The increase in tax revenue is the community's earnings on its investment of infrastructure capital. *Id.* at 118. Rate of return is most commonly applied to rewards from capital expenditures and is generally defined as the ratio of the profits to capital employed. *Id.* at 363. These profits can refer to a first year profit or to the average over the lifetime of the project. *Id.* Many economists, however, consider this method of calculation too simplistic since it does not take into account factors such as the timing of the return of the investment. *Id.* at 118. See also SHIM & SEIGEL, *supra* note 148, at 290.

¹⁵⁶ The discount rate is the rate that the federal government charges to banking institutions changes, which greatly impact the national economy. See SHIM & SIEGEL, *supra* note 148, at 290. This rate is determined by the Federal Reserve Board and is used to control the economic growth of the economy. David Ivanovich, *Fed Trims Rate by ¼ point /4.75% Benchmark Lowest in Four Years*, HOUSTON CHRONICLE, Nov. 18, 1998, at A1.

¹⁵⁷ The discount rate can be found in generally circulated publications such as BARRON'S magazine, *The Economist*, *Investor's Daily*, *The New York Times*, *The Wall Street Journal*, and other metropolitan newspapers. Melvyn N. Freed, Ph.D. & Virgil P. Diodato, Ph.D., BUSINESS INFORMATION DESK REFERENCE - WHERE TO FIND ANSWERS TO BUSINESS QUESTIONS 35 (1991).

¹⁵⁸ The Federal Reserve cuts interests rates as the economy slows to bolster growth. Ivanovich, *supra* note 156, at A1. See also Gary Duncan, *Wall Street Soars as Fed Acts on Rates*, SCOTSMAN, Oct. 16, 1998, at 27 (stating that in an effort to prevent an economic downturn, the Federal Reserve cut the discount interest rate by another quarter percent).

¹⁵⁹ In October 1998, when Allen Greenspan, Chairman of the Federal Reserve, realized that the economy needed a boost, he did not hesitate to lower interests rates by a quarter of a point. Ivanovich, *supra* note 156, at A2.

if the local community's abatement decision is based on a rate of return that is equal to or greater than the discount rate when the economy is slowing, interest rates will be lower and the community can expect a lower return on its tax dollar investment. Conversely, when the economy is growing, the Federal Reserve will raise interest rates and the community can expect a higher rate of return on its investment.¹⁶⁰

This connection to the prime rate creates a natural check on the community's decision to grant a tax abatement. The primary purpose of economic development is to create job opportunities for a community.¹⁶¹ Therefore, when the economy is slowing and interest rates are dropping, the community can lower its expectations for a return on its infrastructure investment in exchange for a corporate investment that has the potential of creating new job opportunities.¹⁶² Conversely, if the economy is growing and the discount rate is higher, a community is less likely to need the additional jobs that a corporation might produce and is in a stronger position to expect a greater return in the form of higher tax revenue.

To illustrate how this analysis would work, assume that the net increase in tax revenue generated by a proposed corporate investment into a community is \$100,000, that the actual costs to the community are calculated at \$1,000,000, and that the discount rate is 4.75 percent.¹⁶³ If the community grants a three-year abatement to the corporation, it can expect to recover its initial infrastructure costs in approximately ten years.¹⁶⁴ Consequently, over that ten-year period, the community will

¹⁶⁰ See, DAVID C. KLINGAMAN, *PRINCIPLES OF MACROECONOMICS* 158-59 (1976) (explaining the Federal Reserve's use of the discount rate to encourage or mute national economic growth); NORMAN F. KEISER, *MACROECONOMICS* 236-47 (1975) (analyzing the Federal Reserve's role in the national economy and its use of the discount rate as a tool to stimulate the national economy); MICHAEL R. DARBY, *MACROECONOMICS: THE THEORY OF INCOME, EMPLOYMENT AND PRICE LEVEL* 255-75 (1976) (describing the policy considerations that affect the Federal Reserve's use of the discount rate to manipulate the national economy).

¹⁶¹ See *supra* note 23 and accompanying text.

¹⁶² This reduced expectation of an increase in revenue can be justified, since, as the economy slows, the unemployment rates will generally be higher. See DARBY, *supra* note 160, at 339-40. Consequently, the community might have a greater interest in the potential job creation the corporation brings to the bargaining table.

¹⁶³ This was the discount rate as of November 18, 1998. Ivanovich, *supra* note 156, at A1.

¹⁶⁴ Using the three-year abatement schedule, the community would receive no increase in tax revenue in the first year, an increase of approximately \$33,000 in the second year, and an increase of approximately \$67,000 in the third year. See *supra* note 68 and accompanying text. After the abatement, the community realizes an increase in revenue of \$100,000 a year. Consequently, it would take just over ten years to recover the initial \$1,000,000 investment.

see an annual return on its investment of approximately ten percent.¹⁶⁵ This rate of return is twice that of the discount rate and, therefore, indicates that the community should make the investment in the project.

On the other hand, assume that the increase in tax revenue is only \$10,000 per year, that the actual costs to the community are calculated at \$1,000,000, and that the discount rate is 4.75 percent. The annual rate of return for the community drops to one percent, one fourth of the discount rate, which indicates that the community should not grant the abatement since the rate of return on its investment is negligible.¹⁶⁶ In both situations, the community has determined for itself whether the project deserves an abatement, and in neither case has the community relied on corporate promises that may not matriculate.

Aside from providing the community concrete factors upon which it can base its decisions, another advantage of this type of cost-benefit analysis is its efficiency.¹⁶⁷ In determining whether an abatement is appropriate, the designating body need only apply the following formulae:

$$1) \text{ Current Tax Revenue/Projected Tax Revenue} = \text{Return}^{168}$$

$$2) \text{ Return/Projected Community Costs} = \text{Rate of Return}^{169}$$

¹⁶⁵ In the example of the project that generated \$100,000 in increased tax revenue for the community's \$1,000,000 infrastructure investment, the average annual rate of return is reduced due to the fact that in the first year the community will receive no return and in the next two it will receive a reduced return. Had the community received \$100,000 for each of those first three years, its average rate of return would have been ten percent and it could have recovered its costs in ten years. This is demonstrated by using the ratio of profits to capital: \$100,000 (profits) divided by \$1,000,000 (capital) equals a 10/100 or ten percent.

¹⁶⁶ $\$10,000/\$1,000,000 = 1/100$ or 1%.

¹⁶⁷ The efficiency comes from the fact that the four key variables are easily obtainable. The tax revenue generated by the property is available at the county assessor's office. See *supra* note 139 and accompanying text. The company is already required to provide information as to the value of its improvements on the property from which the county assessor can determine the increase in tax revenue. See *supra* notes 141-43 and accompanying text. The community has its own information as to what the expected costs of the project are going to be. See *supra* note 154 and accompanying text. Additionally, the discount rate is easily obtainable from any number of publications. See *supra* note 157.

¹⁶⁸ See *supra* note 148 and accompanying text.

¹⁶⁹ See *supra* note 155 and accompanying text.

Once the rate of return is calculated, the community need only compare it to the current federal discount rate. Assuming the comparison is favorable and the community grants the abatement, the only necessary follow-up is to determine whether the corporation increased the tax revenue to a sufficient level through its improvements to the property. If the comparison is not favorable and the abatement is denied, then no other follow-up is necessary.

The primary disadvantage of deciding abatement solely on the increased tax revenue is that some communities suffer from higher than average unemployment.¹⁷⁰ If the state legislature mandated this type of cost-benefit analysis without taking into consideration the potential jobs that a corporation would create, these communities run the risk of having the company locate elsewhere when the project does not increase the community's tax revenue to a sufficient level.¹⁷¹ These communities still face the reality that corporate promises of future job growth are inherently speculative.¹⁷² By requiring an abatement to be conditioned on an increase in future tax revenue, the community can be confident that it will receive at least one benefit from its investment.

Based on these reasons, the Indiana State Legislature should amend Indiana Code § 6-1.1-12.1-3(b) 1-5 to read as follows:

Before a designating body can approve a corporate request for the abatement of property tax, the designating body shall make the following determinations. First, the designating body shall determine the approximate community costs associated with the corporation's investment. Second, the designating body shall divide the estimated increase in tax revenue by the community costs to determine the estimated rate of return associated with these costs. Third, if this rate of return is equal to or greater than federal discount rate at the time of the abatement request, the designating body may consider other factors

¹⁷⁰ For example, the average unemployment rate in the State of Indiana in 1994 was 4.9%. FACT BOOK, *supra* note 4, at 148. The average unemployment rate for Crawford County in that same year was 10.8%. *Id.* With an unemployment rate that was over twice the rate of the overall state, Crawford County could reasonably argue that any potential for new jobs would be worth foregoing some tax revenue.

¹⁷¹ This risk is slim, however, since only a small minority of companies base their location decisions on the availability of tax incentives. See *supra* note 59 and accompanying text.

¹⁷² See *supra* notes 1, 124 and accompanying text.

such as the number of jobs, or level of wages proposed by the corporation. However, no abatement shall be granted in cases where the estimated rate of return on the community's costs is less than the discount rate at the time of application.

With this amendment, the State will be protecting its local municipalities from speculative corporate promises while insuring that these communities at least will benefit from a reasonable return on their investments. This amendment creates a base line from which local communities must start in determining whether an abatement is proper or not. If a project cannot return to a municipality a rate of return from the increase in property value that is at least equal to the federal discount rate, then the municipality cannot grant the abatement. However, if the proposed project meets this minimal standard, the municipality can assess the value of the other benefits associated with the project, knowing that it will at least receive a reasonable return on its investment.

V. CONCLUSION

The use of industrial incentives by communities has a long history in the United States, and there is no indication that these incentives will end soon. While the advantages that are available to the corporation seeking the abatement are clear from the beginning of an abatement process, the current system offers inadequate protection for the communities that grant these requests.

By focusing the decision of granting abatement on an expected rate of return from the increased tax revenue, Indiana communities will be able to identify beneficial projects, reject unfavorable requests for abatement, and have greater success in achieving economic development goals. This approach to abatement allows communities to base their decision to grant abatement on at least one quantifiable factor, while minimizing the administrative costs of policing the companies who have received abatements.

Peter D. Todd