

Dark Store Theory: How Big-Box Stores Bilk Local Governments by Henry Grabar (2019)

Big-box stores like Walmart, Home Depot, Meijers, and Menards are implementing a tax reduction strategy called the dark store theory. The big boxes claim that the market value of their operating store should be based on the sales of similar size “comparable” properties that are vacant and abandoned, hence the name “dark store theory”. The author explains some of the issues with big box stores and tax assessments and how it’s possible, under current law, to do this. The big box is built for one purpose and is ill-suited to adaptive reuse, reducing the number of potential buyers. Many big boxes have anti-competitive deed restrictions preventing other companies that could use the property from doing so. Thus, the shuttered stores are worthless and since they are the only “comparable” property to a brand new operating big box, the new operating big box is also worthless. Big boxes use the loophole to cut property taxes, claiming their property was over assessed and demanding not only a new lower tax rate but also refunds for the previous years they say they were overcharged. The use of the theory is spreading all over the United States. “For small towns where property taxes make up most of the budget, the dark store theory challenges conventional assumptions about city planning, in which the attraction of a mall or mega-retailer is seen as a tax base anchor.”

Dark Store Theory in Michigan’s Upper Peninsula: Impacts and Predictions by Isabelle Karl (2021)

This publication was released by Rural Insights, a research and information source for Michigan’s Upper Peninsula (UP). The dark store theory method of property tax assessment has been a big issue in the rural communities of the UP. The report examines the use of the method in Michigan and what state law says about property assessment and taxation. She gives a detailed description of the local property tax assessment procedure explaining terms and entities like state equalized value (SEV), taxable value (TV), Proposal A, the appeals process with the Michigan Tax Tribunal. From here she discusses the how businesses are using dark store method in Michigan. When a new store is built, the local municipality must determine the true cash value of the property. By law this value is to be determined by comparing the selling prices of similar properties in the area. Normally this is an effective system for residential properties due to a large pool of sales to sample, but it becomes complicated with larger retail properties with few or no similar properties in the area. Thus, in rural areas, dark store method has been especially damaging because they possess less diversified pools of retailers to base assessments on. Also, rural areas are often more dependent on the tax dollars from the one or two big-box stores. Karl analyzes the practice’s impact on local governments and property tax revenues in five UP counties. Losses incurred because of the lower assessments have limited local government services and placed more burden on residents and other businesses. Finally, she covers legislative efforts to close the loophole across the country and in Michigan specifically.

Synthesis

Retailers are lowering the amount of property tax they owe local municipalities through a legal strategy called “dark store theory.” The General Property Tax Act of 1893 mandates the true cash value of a property be determined by comparing the selling prices of similar properties in the area, or “comps” (Garbar, 2019). This system is generally effective for residential properties due to a large pool of sales to sample but things get complicated when there are few or even no “comps” in the area. Dark store theory emerged in the wake of the Great Recession of 2008 when many big boxes were shuttered. “Once the economy began improving (...), big box retailers (...) built new stores rather than repurpose the old ones. The dark store theory was born out of this process of old retailers leaving abandoned buildings with little market value and new retailers building new buildings rather than take over the abandoned buildings” (Karl, 2021). Reasons the abandoned buildings are not reused are that the big box buildings are specialized, built for a single use, utilizing throwaway design. But even more insidious are the anti-competitive deed restrictions the retailers put in place, preventing sale of the property to nearly all possible parties that could actually reuse such a property. Limiting competition is the excuse, the real purpose is by limiting potential buyers and driving down the sales prices they can turn around and use them as “comps” to lower their taxes, as much as 50% in some cases, on their open, bustling stores. “This has resulted in buildings being kept empty and adding to the blight problem in a community. Now the trend is that more and more retailers are starting to use deed restrictions to appeal their assessments. They claim that these self-imposed deed restrictions have lowered the value of their property” (Michigan Municipal League, nd). And trending it is especially in Michigan, and especially in rural areas.

The result of the dark store method is drastically reduced commercial property taxes that directly impact local governments. The tax revenue is used to finance roads, police and fire, schools, libraries, and parks. The effects are long term, in Michigan a 1994 constitutional amendment ensures that taxable value cannot rise by more than 5% a year, meaning it can take years, decades in some cases, to bring the assessed value back to its former levels (Garbar, 2019). The burden falls to the residents who pay in both higher taxes and lowered services.

Governments are taking steps to counter dark store theory. Indiana, New York, Texas, Wisconsin, and Michigan all have either passed or pending legislation to close the loophole (Nanayakkara, 2022). In Michigan, the solution to the problem according to Michigan Municipal League (nd) are:

1. Restricting the consideration of comparable sales that have deed restrictions if those deed restrictions are imposed by the seller to keep competitors of the seller from the market.
2. Recognizing the use of all three assessment approaches (cost, sales comparison and income) based on the particular circumstances, in line with accepted national standards.
3. Examining the Michigan Tax Tribunal process to provide needed guidelines for uniform and fair treatment of appeals.

The most recent efforts aim to add several ruling guidelines to initial assessment and the Tax Tribunal decision processes. These include consideration of the current market that the property is competing in, including the supply and demand for the property, as well as the current and potential uses of the property instead of just using the “comparable sales approach”, stipulations that vacant properties may only be used to assess occupied properties under specific circumstances, and limitations on using deed restricted properties as comparable sales (Karl, 2021). But in Lansing, bills are not getting passed while more and more petitions for lowered assessments are coming in, reminding us of the structural power these consolidated retail giants have over local politics and finances.

Research Question

If you build something that is fundamentally useless to anyone but you, should you have to pay property taxes on it? Should we allow single use building, how can we build with future use in mind. Are the ideas of obsolescence and depreciation still appropriate today with our emphasis on sustainability? How do we reward or incentivize companies to build sustainably in a fast-changing business environment. Should developers/businesses be penalized if their new construction is demolished within a certain time or not transferred to a new use? How widespread and at what rate is dark store theory spreading?

References

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Feb. 11, 2022 A Michigan appeals court upheld the use of the "dark store theory" for the valuation of a Menards home improvement store, saying a judgment by the state tax tribunal correctly valued the...

Sam Hetherington, UP823, Fall 2022

Menards wins tribunal ruling (original ruling)

Escanaba wins appeal-spring 2017

Menards files request to have case heard by Mi Supreme Court-it is rejected and as a result case returned to Tax Tribunal

Menards wins – May 2020

https://reicenter.org/upload/documents/reports/dark_store_final_9-20-19.pdf