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Tax Base

Property taxes have always been lucrative for local governments, but they have also often times been seen as unfair to the people paying them. Businesses especially dislike taxes on tangible personal property. Because of its difficulty to track and detect, some states have chosen to exempt certain components of personal property from their tax base. In this article, Catherine Collins discusses the way states have chosen to handle personal property.

The Shrinking Personal Property Tax: State Approaches to Exempting Business Personal Property From Local Property Taxes

By Catherine Collins

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BACKGROUND

Property taxes have long been the main revenue source for local governments in the United States and the bane of taxpayers. The tax, dating back as far as the early years of the country[1] has been often identified as the most unfair or disliked tax.[2] Given the lengthy history of property taxes in this country, the tax base has evolved. Real estate, which is land and all that

[1] John J. Wallis "American Government Finance in the Long Run: 1790-1990" *Journal of Economic Perspectives*, Vol. 14, No. 1 (Winter 2000).

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is attached to it, remains a constant component because it lacks mobility and therefore can be tracked by the tax department. Tangible personal property, on the other hand, is just the opposite.[3] It is often defined as any property that is not permanently affixed to real property, or alternatively property whose removal does not alter the character or value of the real property on which it is located. Given its mobility, it is easily controlled by the taxpayer and harder to detect and tax. As a result, states have eliminated various components of personal property from their tax base.

The first category of personal property carved out was household personal property—things such as furniture, clothing, and family portraits—excluded by virtually all states. Treatment of cars, mobile homes, aircraft and watercraft are more of a mixed bag. In some states they are taxed as property, while in other states they are subject to an annual registration or some other annual tax. Alternatively, their taxable treatment depends on some other characteristic, such as ownership or mobility of the property.

That leaves business personal property—both inventories and equipment used to generate income—as the bulk of the taxable personal property. Increasingly, however, inventory is being exempted. This may be in part because taxpayers can easily limit their liabilities by controlling the inventory on hand on assessment day. It has been reported that prior to Indiana's exempting inventories in 2007, businesses would have ''inventory sale days'' just before the assessment date.[4]

[2] Marike Cabral and Caroline Hoxby report on the ACIR and Gallop polls in ''the Hated Property Tax'' Working Paper 18514 *NBER Working Paper Series* November 2012.

[3] Thoughout this paper, ''personal property'' refers to ''tangible personal property.'' For ease of reading, tangible has been dropped. Tangible personal property is comprised of such things as machinery, furniture and tools. Intangible personal property is stocks, money and bonds.

[4] Purdue University: The Property Tax on Business Inventories http://www.agecon.purdue.edu/crd/localgov/second%20level%20pages/topic_inventory_tax.htm

Untaxing Business Personal Property. While states have eliminated portions of personal property, business personal property is still part of the property tax base in 36 states.[5] The difference as to what business property is taxed is shown in the table below. Although the share of the tax base attributed to personal property is not generally substantial, averaging something less than 10 percent, it varies widely across states.[6] Personal property's share is greatest in Louisiana, accounting for 30 percent of that state's tax base, while it is less than one percent in Wyoming.[7] Wide variations are also prevalent within a state. In 30 Michigan communities, taxable personal property accounts for over 30 percent of their tax base, while statewide the average is less than 10 percent.[8] In addition, it is not uncommon for the tax burden to be highly concentrated among a few taxpayers. In Indiana, the bulk of the taxpayers, 70 percent, have liabilities of less than $20,000 and account for only 21 percent of the personal property taxes paid in 2013.[9]

[5] Five of the 36 states provide local governments with some flexibility in taxing personal property. Local option in some states is to tax personal property, while in others it is to exempt all or some of it.

[6] Not all states report personal property separately. These statistics are based on the 32 states that do report personal property separately. Derived from ''Significant Features of the Property Tax, Tax Base by Property Type.''

[7] This differential points out one of the problems with comparing state property taxes. Louisiana's personal property includes a significant portion of oil and gas property associated with processing and refining as well as inventory. In Wyoming, oil and gas production is assessed at the state level with no distinction between real and personal property. The one percent in Wyoming is only the locally assessed commercial and residential personal property.

[8] Citizens Research Council of Michigan, ''Statewide Ballot Issues: Proposal 2014-1 Voter approval of new statewide local tax to reimburse local governments for PPT reforms'' *CRC Memorandum* July 2014, p. 5.

[9] John Stafford and Larry DeBoer, The Personal Property Tax in Indiana: its reduction or elimination is no simple task *Information Brief*, Indiana Fiscal Policy Institute (February 2014).

2014 Personal Property Taxation

State	Inventory*	Business Property*	Exempt Value Threshold +	State Replacement Provided*	Notes
Alabama	E	E			
Alaska	Local option	Local option			
Arizona	E	T	$141,385		Statewide exempt value per taxpayer
Arkansas	T	T			
California	E	T	de minius		
Colorado	E	T	$7,000		
Connecticut	E	T			Manufacturing personal property exempt
Delaware	E	E			
District of Columbia	E	T	$225,000		
Florida	E	T	$25,000		

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2014 Personal Property Taxation – Continued

State	Inventory*	Business Property*	Exempt Value Threshold +	State Replacement Provided*	Notes
Georgia	Local option	T	$7,500		Inventory exempt for state property tax
Hawaii	E	E			
Idaho	E	T	$100,000 /$3,000 per new item	Y	Exempt value per taxpayer per county
Illinois	E	E		Y	
Indiana	E	T			
Iowa	E	E			
Kansas	E	T		Y	Equipment put in service after June 30, 2006 exempt
Kentucky	T	T			Some may be taxed only by the state
Louisiana	T	T			
Maine	E	T		Y	Equipment put in service on or after April 1 2007 exempt
Maryland	Local option	Local option			Manufacturing and R&D personal property exempt. Inventory exempt for state.
Massachusetts	E	T			At local option may exempt up to $10,000
Michigan	E	E		Y	
Minnesota	E	E			
Mississippi	T	T			Taxed at higher rate
Missouri	E	T			Taxed at higher rate
Montana	E	T	$100,000		Remaining taxable property taxed at two rates
Nebraska	E	T			Taxed if depreciable for federal tax purposes
Nevada	E	T			
New Hampshire	E	E			
New Jersey	E	E			
New Mexico	E	T			
New York	E	E			
North Carolina	E	T			
North Dakota	E	E			Certain oil and gas machinery and equipment taxed as real property
Ohio	E	E		Y	Reimbursement phased out until 2019
Oklahoma	T	T			Assessment ratio at local option
Oregon	E	T			Local assessor may cancel assessment if less than $16,000
Pennsylvania	E	E			
Rhode Island	E	Local			Manufacturing machinery and equipment exempt
South Carolina	E	T			Personal property assessed at higher ratio
South Dakota	E	E			Centrally assessed property is taxed
Tennessee	E	T			Personal property assessed at lower ratio
Texas	T	T	$500		

2014 Personal Property Taxation – Continued

State	Inventory*	Business Property*	Exempt Value Threshold +	State Replacement Provided*	Notes
Utah	E	T	$10,000		Exempt value per taxpayer per county
Vermont	Local option	Local option			
Virginia	Local option	Local option			
Washington	E	T	$500		
West Virginia	T	T			
Wisconsin	E	T			
Wyoming	E	T			

*E =exempted; T=taxed; Y=yes; + Exemption up to threshold value.

Source: Compiled by the author from ''Significant Features of the Property Tax,'' Lincoln Institute of Land Policy and George Washington Institute of Public Policy http://www.lincolninst.edu/subcenters/significant-features-property-tax/Report_Taxable_Personal_Property.aspx.

Increasingly, the business community and others have sought to have the tax eliminated; arguing that the tax is burdensome, like paying a sales tax each year on such things as furniture and equipment.[10] Taxing such property also imposes a heavy administrative burden. Unlike real property, which is assessed by the taxing officials, business property is reported directly by businesses themselves. They self-report all their business property, listing the location, age, and value of all personal property.[11] This paperwork is burdensome for both the taxpayer and the taxing jurisdiction.

While sympathetic to business concerns, legislators are also aware of the fiscal strain exempting such property could pose to local governments, whether reducing revenues for public services or shifting the burden to the remaining taxpayers. States have considered a variety of strategies to balance both interests which include:

- Allowing each local jurisdiction the option of providing the exemption if appropriate for its community;
- Providing the exemption statewide and allowing local jurisdictions to replace revenue loss by increasing the tax on the remaining property or imposing an alternative tax;
- Providing the exemption statewide and backfilling the loss of local revenues with state revenues;

Each of these options has been adopted in some manner in one or more states. However, the interplay of exemptions and the resulting shift of the local burden with the overlay of other tax features, such as rate and levy limits, complicates structuring tax relief. Recent state actions to exempt business personal property demonstrate the difficulty in implementing any such exemption.

Locally-Determined Relief. Several states allow local governments to decide if they want to exempt any or all of business personal property. Leaving this decision to each taxing jurisdiction may compound the burden for taxpayers, especially if the business has multiple locations. In Maryland, for example, both counties and local governments can determine if either inventory or business equipment is exempt. Specifically, state law authorizes counties and municipalities to exempt the personal property used in manufacturing and in research and development as well as exempting inventory.[12] While all but five of the counties provide these exemptions, all other personal property is taxed, and in some counties and locations, at higher rates than real property. Because the exemptions are granted jurisdiction by jurisdiction, businesses are not relieved from having to report the property. However, the reporting is somewhat less burdensome because all reporting and assessment is centralized at the state level.

In some states, local governments are allowed to increase their tax rate to replace the lost revenues. However, local governments may not be able to increase their rates, given state-imposed limitations on rate or levy increases. An analysis of a suggested program in Indiana found that such an option would have uneven effects across the state. Jurisdictions that were at or near their maximum rate would be unable to increase rates sufficiently to make up for the foregone revenues.[13]

In Missouri, the business personal property exemption was replaced with a local surcharge. Beginning in 1985, the tax on merchants' and manufacturers' tangible personal property was eliminated. To make up for the lost revenues, a surcharge on commercial real estate was imposed in each county.[14] Because much of the economic activity was concentrated in urban areas, particularly St. Louis and Kansas City, these county surcharges were significantly higher than in the lesser-developed surrounding counties. Growth and develop-

[10] Joyce Errecart, Ed Gerrish, and Scott Drenkard. *State Moving Away from Taxes on Tangible Personal Property* Tax Foundation Background Paper No. 63 (October 2012), http://taxfoundation.org/article/states-moving-away-taxes-tangible-personal-property

[11] Unlike business property, utility property is generally assessed centrally at the state level with the value of the property allocated among the jurisdictions.

[12] Md. Code Ann. Tax Prop. §§7-108 – 7-109.

[13] Stafford, Indiana.

[14] Mo. Rev. Stat. §139.600.

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ment patterns have changed since 1985, spreading outward from the cities. The result is that significant rate differential remains, making the higher taxes in the older cities less attractive for new or expanding businesses.[15]

State Solutions. Allowing locally-imposed replacement taxes may not reduce the tax and administrative burden on businesses and jurisdictions. An alternative is for the state to reimburse local jurisdictions using revenues from a broader, statewide tax. Between 2008 and 2014, at least eight states have taken steps to significantly reduce the tax burden on business personal property and backfill the local revenue loss with state revenues.

Ohio phased out the tax on businesses in three stages, so that by 2009, personal property was no longer taxed.[16] As the state phased out the tax on personal property and the state corporate franchise tax, it imposed a gross receipts tax and commercial activity tax (CAT) on businesses operating in the state with revenues split three ways: the general fund and reimbursement funds for school districts and for local governments.[17] However, in the initial years, the CAT revenues fell short, providing only about half the funds needed to reimburse schools and local governments. General fund revenues were used to supplement the reimbursements. Subsequently, the state made several changes in calculating the reimbursement and the allocation of CAT revenues. The latest change, made in 2013, lowered the reimbursements to school districts and local governments and increased the allocation to the state to 50 percent, cutting the reimbursement to schools and local governments almost in half.[18]

While Ohio's tax reform implemented a new statewide tax, Michigan sought to distribute the state's sales tax to reimburse the exemption of personal property. Because of the state constitution, Michigan voters had to approve the conversion of a portion of the state's use tax to a special fund to reimburse local governments, in effect making the state tax a local tax. With strong voter approval in August, the changes to exempt personal property enacted both in 2012 and 2014 can now go forward. Like Ohio, Michigan will phase in the exemption, but over a much longer period, lasting until 2023. The first provision provides immediate relief by exempting personal property for businesses with $80,000 or less in personal property in a taxing jurisdiction. The second component is to phase in the exemption, depending upon when the property was put in service. Beginning in 2016, all new property put in service in 2013 will be exempt, as well as property that had been in service in the preceding 10 years (2005 or earlier in 2016, 2006 in 2017, etc.) By 2023, all personal property will be exempt. Making up for these lost revenues falls to both the state and local governments. Beginning in 2016, local jurisdictions have the option to impose a special assessment to cover costs associated with maintaining or purchasing equipment for essential services, such as police and fire services. This assessment is to be imposed on the real property associated with the newly exempt personal property.[19] The state reimbursement will be calculated, assuming the assessment has been adopted even if a jurisdiction does not impose it. This allows the local jurisdiction to choose to provide relief to the taxpayers or to maintain government spending.

The reimbursement in Michigan is likewise phased in, with changes to the distribution formula incorporated in the initial legislation. The initial reimbursement will offset only for the tax levied for debt service but not the $80,000 exemption. Moreover, reimbursement will be available only to those jurisdictions that lost more than 2.3 percent of taxable value because of the exemption. Although total reimbursement is expected to cover 83 percent of lost local revenue, it comes with a price to the state's general fund. By the final year of the phase-in, 2022-23, state sales tax revenues are expected to be reduced by over $400 million.[20]

To prevent a drain on state's revenues, some states set a limit on reimbursements. For example, Illinois limits its reimbursement to the revenues generated from the state tax on business income and invested capital which was specifically imposed to reimburse local governments. With personal property eliminated by 1979, the revenue generated from the new tax is distributed to local taxing jurisdictions in proportion to the amount received from the personal property tax for the 1977 tax year.[21]

In 2013, Idaho took two steps to limit the taxes on personal property and limit the state's exposure to replace local revenues. All personal property items that were purchased on or after Jan. 1, 2013, will not be added to the tax rolls. Since those items are not taxed, no reimbursement for lost revenue is needed. At the same time, the state increased the personal property exemption for a business to $100,000 in each county.[22] This exemption provides relief to 90 percent of businesses, but statewide, reduces revenues by only 20 percent.[23] The state has fixed reimbursement to be the

[15] There is an extensive body of literature on the effect of taxes on economic development and business location. While many of these studies have indicated that taxes are not a primary determinate for business location, there is stronger evidence that taxes and tax incentives have a greater impact on intraregional than interregional location decisions. See Yonghong Wu, ''Property Tax Exportation and Its Effects on Local Business Establishments: The Case of Massachusetts Municipalities'' *Economic Development Quarterly*, Vol. 24, No. 3 2010.

[16] Ohio Rev. Code Ann. §5711.22.

[17] For school districts, the final payment was to be in fiscal year 2018 and for local governments in tax year 2018. Ohio Rev. Code §§5757.21 (c)(10)-(c)(19); 5751.22(A)(1)(a)-(i).

[18] Ohio Department of Taxation ''Explanation of Law Changes Enacted in 2011 Relating to the Reimbursement of Foregone Tangible Personal Property Taxes and Modification to State Tax Revenue Streams'' http://www.tax.ohio.gov/portals/0/personal_property/TPR_Reimb_Electric_Gas_Dereg_Reimb_May2012.pdf

[19] Citizens Research Council of Michigan, ''Statewide Ballot Issues: Proposal 2014-1 Voter approval of a new statewide local tax to reimburse local governments for PPT reforms'' CRC Memorandum, July 2014.

[20] David Zin, Senate Fiscal Agency, Personal Property Tax Reform Legislation State Notes Topics of Legislative Interest (Winter 2013) www.senate.michigan.gov/sfa

[21] Illinois Department of Revenue Property Tax Administration, ''The Illinois Property Tax System'' March 2014 p. 5 http://www.revenue.state.il.us/publications/localgovernment/ptax1004.pdf

[22] Idaho Code Ann. §63-602KK.

[23] Boise State Public Radio ''The Ultimate Guide to Idaho's Personal Property Tax.'' http://boisestatepublicradio.org/topic/ultimate-guide-idahos-personal-property-tax

amount of taxes lost as of 2013. The replacement amount is estimated to be $20 million, funded from the state's sales tax. In addition to relieving the tax burden, the new law reduces the reporting burden.[24] Businesses with less than $100,000 of personal property no longer have to file an annual listing of property, and unless the exempted value exceeds the actual value, there is no need to reapply every five years.

Arizona is reducing the taxable value on personal property over time. Currently, the reduction in the assessment ratio for business and agricultural personal property is being phased in over ten years beginning in 2016, going from 25 percent to 18 percent. In addition, the exempt value is annually adjusted based on the changes in the Bureau of Labor Statistics Employment Cost Index. The value of the exemption has increased from the original $50,000 in place prior to 2006 to $141,385 for 2014.[25] Unlike other state programs, Arizona does not provide reimbursement to local governments; rather, the state anticipates that local governments will be able to make up the forgone revenues by shifting the burden to the remaining taxpayers, including businesses paying taxes on their real property.

[24] Fiscal Note Statement of Purpose H.B. 315 http://www.legislature.idaho.gov/legislation/2013/H0315SOP.pdf

[25] Arizona Department of Revenue, Property Tax Division Personal Property Manual Chapter 2 Business Personal Property Effective Jan. 1, 2014, http://www.azdor.gov/Portals/0/Brochure/AZ-Personal-property-Manual.pdf

CONCLUSION

While states may be sympathetic to business demands to eliminate the property tax on personal property, the legislators need to remain mindful of the impact on local governments. As is the case with any incentive program, the tradeoff of eliminating a perceived unfair burden with the costs of providing relief must be addressed. Allowing locals to decide either to exempt or to provide a backfill by imposing an alternative local tax may result in a patchwork approach which reduces neither tax nor administrative burden. Alternatively, using revenues from broader state tax, whether it is a new or existing revenue source, may initially provide both relief to businesses and replacement revenues for local governments. However, relying on state funds introduces political and economic uncertainties, which may jeopardize future reimbursements to local governments.

An added benefit of exempting the tax on personal property may be administrative relief for both the taxpayer and the property tax administrators. As seen in several states, by reducing the reporting requirements, a large number of smaller businesses benefit from not having to file a return without there being a significant revenue hit for local governments. States may conclude that exempting personal property is a cost-effective way to improve the local business environment and reduce the cost of administering the property tax without a significant commitment of state revenues to reimburse local governments.

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