

# Business Property Tax Reform: Look Out Below

Current State, Recent Reforms, Potential  
Responses

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Conference on Future State Business Tax Reforms

# Overview

- Property taxes account for largest share of total state and local taxes on business
- Business property tax reduction has been central to major business tax reforms in Ohio, Texas, and Michigan
- Common themes:
  - Reforms designed to increase statewide tax competitiveness
  - Property tax on homeowners: already beyond sustainable levels?
  - Reduction in local taxes offset by increased state-level aid to locals
  - Net impact on local jurisdictions likely to be negative after transition period
- Taxpayer revolt?
  - Homeowners hold the voting power (Indiana)
  - Business property taxpayers vote with investment decisions
  - Each contribute nearly equal amounts of local revenue

# State and Local Fiscal Drivers

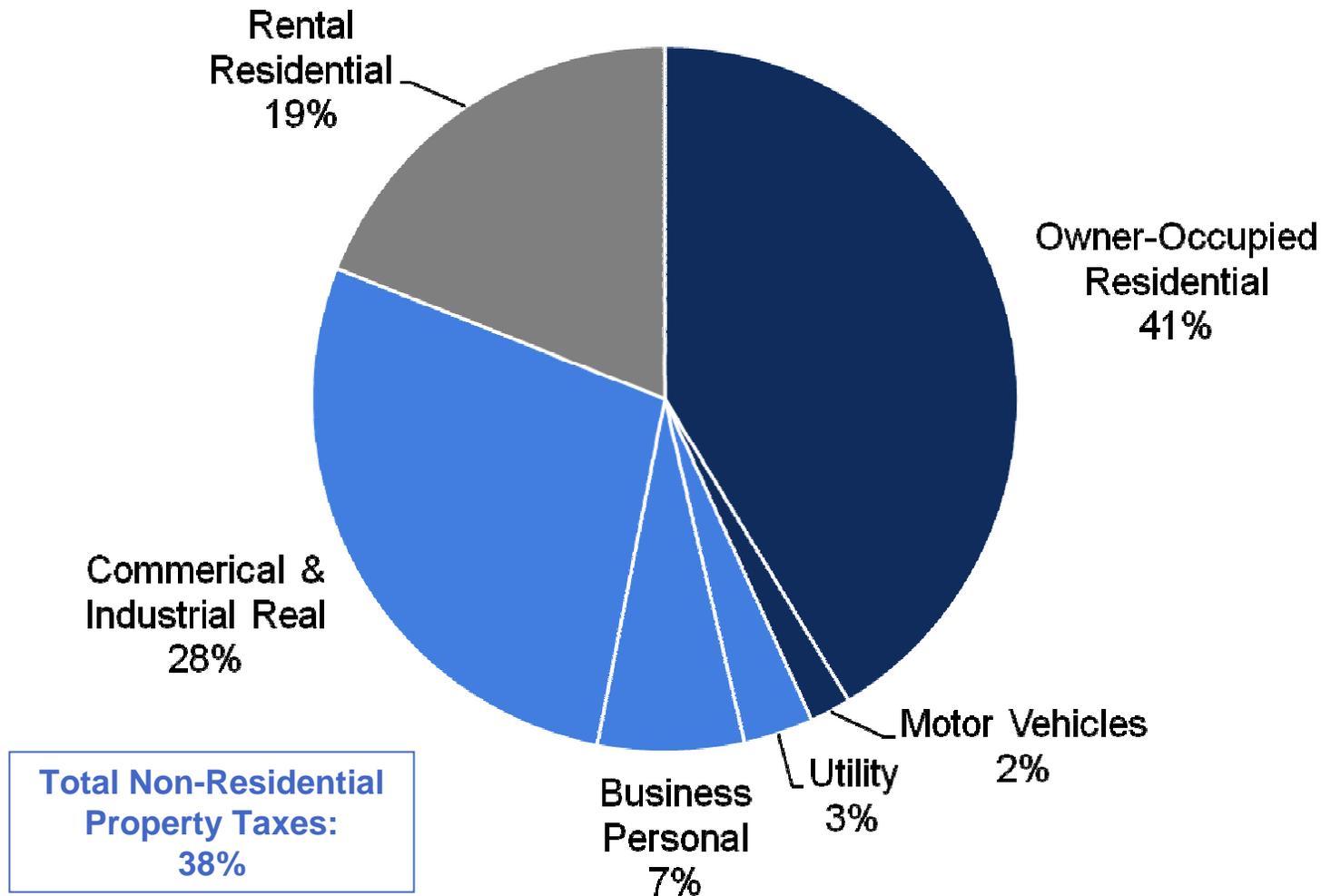
- Total state and local tax collections for FY 2006:
  - \$1.2 trillion
- Total state and local tax distribution by tax type for FY 2006:

|   |     |
|---|-----|
| ■ Income tax (individual and corporate) | 26% |
| ■ Excise tax                            | 11% |
| ■ License and other                     | 8%  |
| ■ Sales and gross receipts              | 24% |
| ■ Local and state property tax          | 31% |

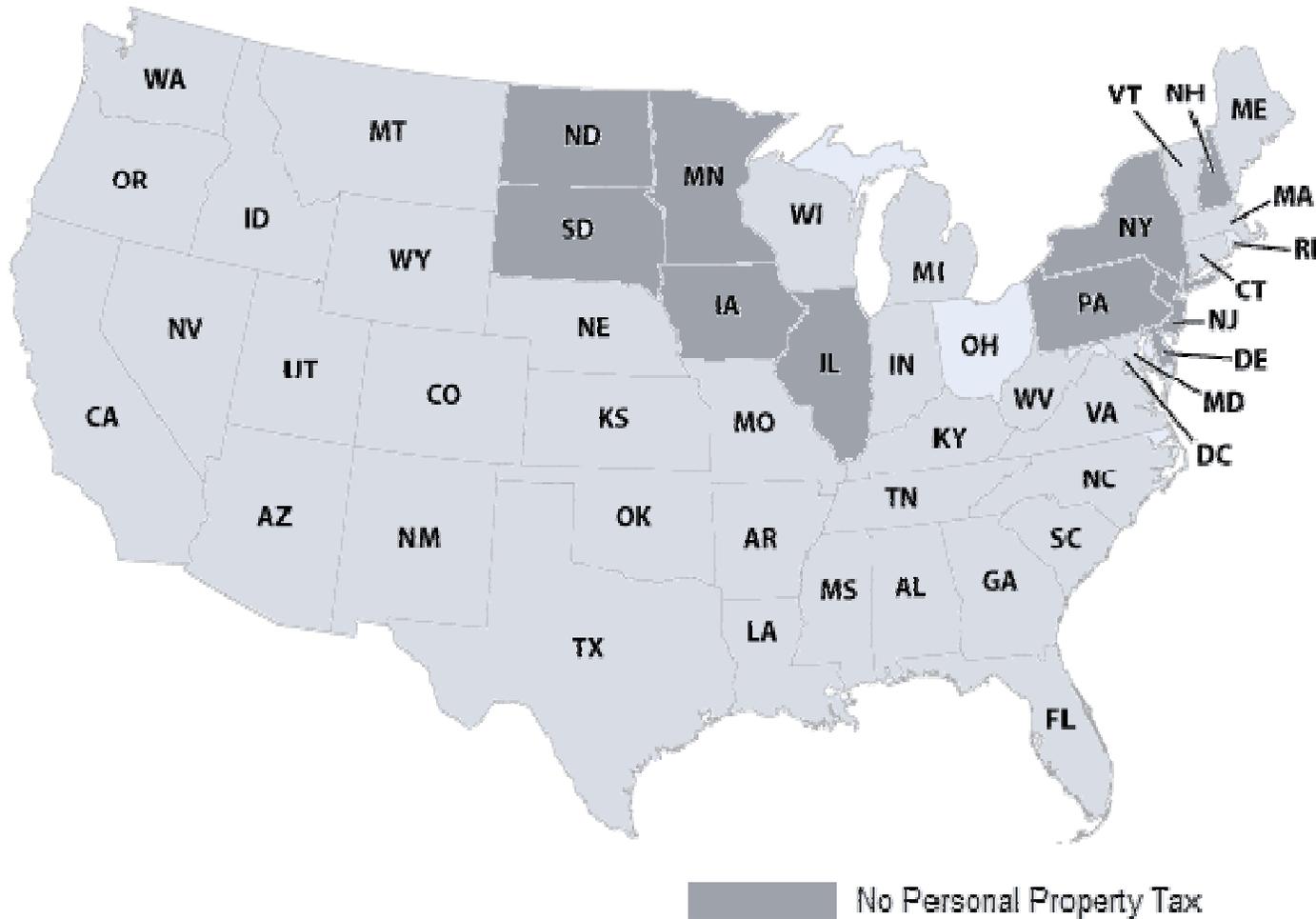
# Property and Other State & Local Business Taxes

| Business Tax                         | FY2006         | % of Total    | 1-Yr Growth  |
|--------------------------------------|----------------|---------------|--------------|
| Property taxes on business property  | \$204.8        | 37.0%         | 9.0%         |
| Sales and use tax on business inputs | 124.7          | 22.5          | 11.6         |
| Corporate income tax                 | 51.8           | 9.4           | 23.1         |
| Unemployment insurance               | 36.4           | 6.6           | 2.5          |
| Excise taxes                         | 25.7           | 4.6           | 4.7          |
| Public utility taxes                 | 24.5           | 4.4           | -2.2         |
| Business and corporate license       | 22.4           | 4.0           | 7.4          |
| Individual income tax on bus. income | 21.4           | 3.9           | 13.1         |
| Insurance premiums tax               | 14.8           | 2.7           | 5.3          |
| Other business taxes                 | 27.0           | 4.9           | 25.2         |
| <b>Total State and Local Taxes</b>   | <b>\$553.7</b> | <b>100.0%</b> | <b>10.2%</b> |

# Composition of FY2006 Property Taxes



# Personal Property Taxation



# Recent Reforms in Business Property Taxation

- Ohio: Personal property tax = 12.5% of total property tax
  - Immediate exemption of new tangible personal property
  - Five-year phase-out of existing property
- Ohio (HB66)
  - Adopted Commercial Activity Tax (CAT) and business personal property tax exemption
  - Projected impact on business taxes, FY2010
    - CAT revenue projection FY2010: +\$1,305 mil
    - Personal property tax exemption: -\$1,293 mil
    - Other business tax changes: -\$1,382 mil
    - Total Business Tax Change: -\$1,371 mil
  - Local government revenue impact (FY2010): -\$1,293 million
  - After state-aid, local jurisdictions expect significant redistribution of revenue

# Recent Reforms in Business Property Taxation

## ■ Michigan

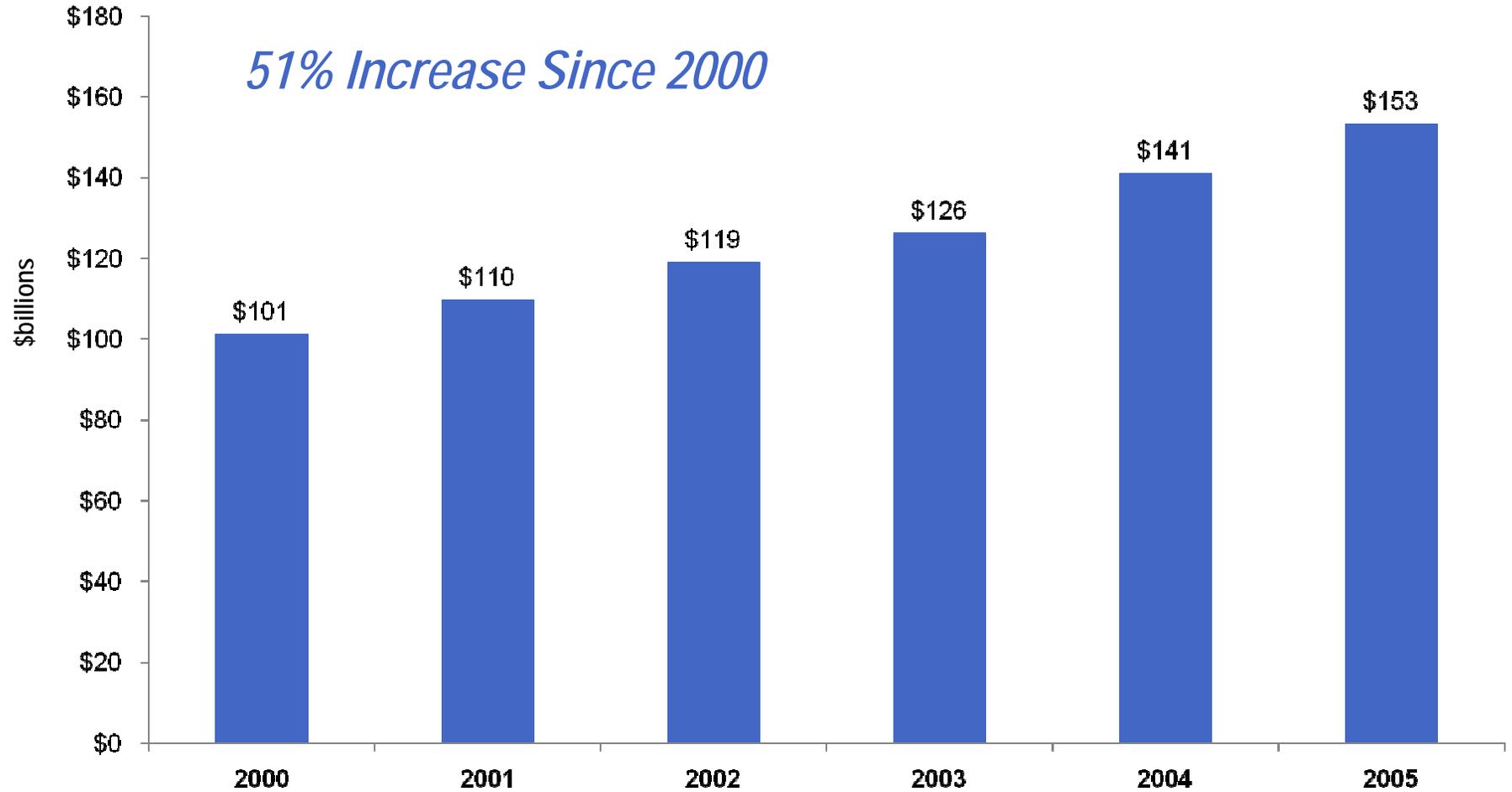
- Replacement of Single Business Tax coupled with personal property tax millage rate reduction and credit for commercial and industrial taxpayers
  - Commercial taxpayers:
    - 23% reduction in personal property tax
  - Industrial taxpayers:
    - 46% reduction in personal property tax
    - 35% credit on remaining personal property tax
- Local distribution of replacement indexed to inflation after 2008
  - Property taxes have increasing at over 8% annually
  - Inflation-indexed distributions may grow 3% annually
  - Result: unmet gap in local revenue may increase 5% annually after 2008

# Recent Reforms in Business Property Taxation

## ■ Texas

- Local property taxes = \$30.9 billion in FY2005
  - 47% of total state and local taxes compared to 33% nationwide
- 1.0% property tax cap imposed in 2006
  - \$3.4 billion business property tax reduction
  - \$3.1 billion homeowner property tax reduction
  - Total property tax impact = \$6.5 billion (20% reduction)
- Replacement revenue?

# Residential Property Taxes: Pushed to the Limit



# Making up the Difference: Predicting Local Government Responses to Property Tax Cuts

- In 2005, 67 percent of taxing jurisdictions reporting revenue shortfall
- How state and local governments will make up shortfall (COST survey):
  - #1 Answer: Property Tax Values, Mill Rates, and BPP Audits
  - #2 Answer: Sales & Use Tax Collections and Audits
  - #3 Answer: Increased Fees

# The Scope of Personal Property Taxation

- Fastest growing area of state government
  - In-house auditors
  - Use of third-party firms
- Forty states (plus D.C. and Puerto Rico) tax BPP
- Eleven states tax inventory

# Basic Issues of Taxability

- Classification – Is the asset accurately classed for both depreciation and taxability?
- Accretion – Does the asset represent a single item or a collection of many, some of which may have different lives or not be taxable?
- Taxability – Pollution control, intangibles, software: Is the asset even there (ghost assets)?
- Obsolescence – Does it work as planned? Is it operating at capacity? Can something new do it better or cheaper?
- Inventory – Is it classed correctly? Freeport, FTZ?