Business Property Tax Reform: Look Out Below
Current State, Recent Reforms, Potential Responses
Billy Michalewicz and Andrew Phillips
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

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

- Owner-Occupied Residential: 41%
- Commercial & Industrial Real: 28%
- Rental Residential: 19%
- Business Personal: 7%
- Utility: 3%
- Motor Vehicles: 2%

Total Non-Residential Property Taxes: 38%
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

51% Increase Since 2000

<table>
<thead>
<tr>
<th>Year</th>
<th>Billions</th>
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<tbody>
<tr>
<td>2000</td>
<td>$101</td>
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<tr>
<td>2001</td>
<td>$110</td>
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<tr>
<td>2002</td>
<td>$119</td>
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<tr>
<td>2003</td>
<td>$126</td>
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<tr>
<td>2004</td>
<td>$141</td>
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<tr>
<td>2005</td>
<td>$153</td>
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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?