



THE PERSONAL PROPERTY TAX IN INDIANA: ITS REDUCTION OR ELIMINATION IS NO SIMPLE TASK

Information Brief

John Stafford

Retired Director of the Community Research Institute
Indiana University-Purdue University at Fort Wayne

Larry DeBoer

Professor of Agricultural Economics
Purdue University

February 2014

About the Authors

John Stafford is the recently retired Director of the Community Research Institute at IPFW. He continues to teach classes in public finance in the Department of Public Policy at IPFW. He is a graduate of Ball State University with a Bachelor of Science degree in urban planning and political science. Mr. Stafford received his master's degree in urban planning from the University of Illinois. He previously served the City of Fort Wayne in several capacities, including Director of Strategic Planning, Chief of Staff, Director of Economic Development, and Director of Long-Range Planning and Zoning. He has also served as the Deputy Director for the Allen County Plan Commission and as the Vice-President of Government and Community Affairs with the Greater Fort Wayne Chamber of Commerce. He has served on the Indiana Property Tax Control Board and the Commission to Reform Local Government, as well as on numerous local boards and commissions.

Larry DeBoer is a professor and extension specialist in Agricultural Economics at Purdue University. DeBoer joined the Purdue faculty in 1984. He studies state and local government public policy, including such topics as government budget and taxing options, issues of property tax assessment, local government revenue options, and the fiscal impact of economic development. He has worked with the Indiana Legislative Services Agency on tax and finance issues since 1988. He contributes to the annual state revenue forecasts. He helps maintain a model of the property tax used by the Indiana state legislature to analyze the impacts of assessment and tax policy changes. DeBoer directed a study on market value property tax assessment for the Indiana State Board of Tax Commissioners during 1995-97. He directed the staff work for Governor O'Bannon's Citizen's Commission on Taxation, 1997-98, and contributed research to Governor Daniels' Commission on Local Government Reform in 2007. DeBoer was the 2009 recipient of Purdue's Hovde Award for service to the rural people of Indiana, and the 2010 recipient of the Indiana Association of Public School Superintendent's Distinguished Service Award.

Larry DeBoer earned his undergraduate degree at Earlham College in Richmond, Indiana in 1978, and his Ph.D. at Syracuse University in Syracuse, New York in 1983. He taught economics at Ball State University in Muncie, Indiana from 1982 to 1984, before joining Purdue in September 1984.

Indiana Fiscal Policy Institute

The Indiana Fiscal Policy Institute (IFPI), formed in 1987, is a private, non-profit governmental research organization. The IFPI's mission is to enhance the effectiveness and accountability of state and local government through the education of public sector, business and labor leaders on significant fiscal policy questions, and the consequences of state and local decisions. The IFPI makes a significant contribution to the important, on-going debate over the appropriate role of government. The IFPI does not lobby, support or oppose candidates for public office. Instead it relies on objective research evidence as the basis for assessing sound state fiscal policy.

Indiana Fiscal Policy Institute
One American Square, Suite 150
Indianapolis, IN 46282
Phone: 317-366-2431
www.indianafiscal.org

The Personal Property Tax In Indiana: Its Reduction Or Elimination Is No Simple Task

Executive Summary

It could be said the Indiana General Assembly has been working to eliminate the business personal property tax since 1966, the year Hoosiers approved a constitutional amendment that allowed lawmakers to separate taxation on real and personal property. Since then personal property taxes have been eliminated on intangible property like stocks and bonds, household goods such as furniture, on vehicles including cars and planes and boats, and, most recently, on inventory. The only remaining category of personal property taxed by the state: business personal property.

Bills to alter or eliminate the personal property tax on business equipment and machinery were introduced in the last three legislative sessions, but they all died in committee. The issue gained new momentum last fall, though, when Gov. Mike Pence endorsed the repeal called for by business interests. Since then House Bill 1001 and Senate Bill 1, which take two distinctly different approaches to the tax, have moved steadily through the process.

While public testimony has discussed many aspects of these legislative efforts and their effect on Indiana's fiscal policy, this report is a comprehensive look at the issue, including new information about the complicating factors presented by the property tax caps enacted in 2008. The report notes that distortions still rippling through the property tax system created by the caps currently favor individual taxpayers—homeowners—and that has spurred the effort to reduce or eliminate the personal property tax on business. Those very caps now enshrined in the state's constitution, however, limit legislators' ability to rebalance the property tax burden among homeowners and business interests, according to the report. All of this is of special interest to local governments, which receive the revenue from property taxes and themselves are still adapting to the changes wrought by the property tax caps.

Among the report's other findings:

- The potential revenue loss to local governments is direct, but the bigger issues include losses due to more homeowners reaching property tax caps and the challenge for local government to replace revenue lost in tax increment financing districts and enterprise zones.
- Studies have shown taxes on business personal property have a small effect on business relocation from outside a state, but depending on the structure if enacted could have a larger effect on relocation decisions from county to county within the state.
- A small minority of Indiana businesses pay the vast majority of business personal property tax.
- Local governments already have abated 10 percent of business personal property taxes statewide.

The General Assembly has a plethora of options to address the issue. This report examines them in detail and discusses their fiscal ramifications, including some not currently considered in legislation. Before changes are made, though, it's important to understand how those changes would affect taxpayers and local governments, including public schools. This report shows on a county-by-county basis the effect of eliminating the business personal property tax, which areas are most affected by eliminating the tax and the interplay between property taxes, tax caps and local levies.

These factors lead to the real policy question: Is elimination of the business personal property tax primarily an economic development proposal, or primarily a taxation policy proposal. The answer is both, and it's up to the General Assembly to find the right mix. "To reach a successful outcome," the report concludes, "political credit for tax reductions and political blame for offsetting tax increases must be shared by both the General Assembly and by local elected officials." It's a tall order, especially given the complications presented by property tax caps, but the early results from this legislative session indicate a higher level of creativity, compromise and momentum for this issue.

What Is Personal Property And How Is It Taxed In Indiana?

Decades ago personal property in Indiana, for taxation purposes, included household goods (furniture); transportation equipment (automobiles, boats and airplanes); intangible property (stocks and bonds); business inventory; and business equipment. As is further discussed in a subsequent section, Indiana has removed most of those components from the property tax base and essentially only business equipment remains as the taxable portion of personal property. Personal property is more specifically defined in Indiana 6-1.1-1-11.

Personal property is mainly business equipment used in the production of income or held as an investment. Personal property values are self-assessed by property owners as of March 1 each year and reported to assessors on standard state forms by May 15. The assessed value of property is taxed in the following year.

Owners of personal property classify the property into one of four "pools" based on the expected life of the equipment (there is a fifth pool that applies to steel mills). Property enters at its initial cost and is depreciated based on age. The shortest lived property can depreciate to 20 percent of its initial cost; the longest lived property depreciates to 5 percent of cost. However, in total a taxpayer's personal property cannot be assessed at less than 30 percent of its initial cost. This is known as the "30-percent floor."

In Indiana, the non-exempt components of personal property are taxed at the same rate as land and buildings (commonly referred to as "real property"). The rules under which personal property is assessed are governed by Indiana Code 6-1.1-3 and Title 50, Article 4.2 of the Indiana Administrative Code. The Indiana Department of Local Government Finance has been given the responsibility for implementing these rules and procedures.

A History Of Narrowing The Portion Of Personal Property Subject To Property Taxation

The potential elimination of the property taxation of business tangible property would be yet one more in a long history of narrowing the personal property tax base in Indiana. In fact, it could be the final chapter in this saga. For decades taxable personal property consisted of five basic components: (1) intangible property (such as stocks and bonds); (2) household goods; (3) motor vehicles and other means of transportation; (4) inventory; and (5) business equipment.

In 1966 Indiana voters approved an amendment to the state constitution's Article 10, Section 1. This provision had previously provided for the "taxation of all property, both real and personal." The 1966 amendment allowed the General Assembly to exempt "any motor vehicles, mobile homes, airplanes, boats, trailers or similar property, provided that an excise tax in lieu of the property tax is substituted therefore." The General Assembly did indeed follow up with enactment of the auto excise tax in 1969 legislation (effective in January, 1971).¹

A second amendment to the state constitution, also adopted in 1966, allowed for the exemption of both intangible personal property and household goods.² This left only inventory and business equipment as remaining taxable components of personal property.

Efforts to remove inventory from the tax base began to gain steam in the late 1990s. Indiana's slogan as the "Crossroads of America" is a reference to its strong transportation assets and location in proximity to much of the nation's population. The argument was forwarded that Indiana's taxation of inventory, or at least that portion not subject to the Interstate Commerce clause exemption, was limiting the state's economic potential as a center for warehousing and distribution. These efforts ultimately resulted in the phase-out of the inventory tax being included in the major tax restructuring package adopted during the 2002 Special Session.³ The Indiana Constitution was subsequently amended in 2004 with language that authorized the General Assembly's exemption of the inventory tax. Now only business equipment remains as a substantive component of taxable personal property.

Elimination of inventory from the tax base resulted in a \$17.1 billion reduction in the statewide property tax base. The resulting rise in tax rates caused a shift in the property tax burden to owners of other taxable property. To protect homeowners from the shift, the 2002 tax restructuring legislation (HEA 1001 – 2002 Special Session) included a provision to allow individual counties to adopt a local option CEDIT Homestead Replacement Credit.⁴

¹ *Financing Local Government in Indiana*; David J. Bennett and Stephanie E. Stulich; Lincoln Printing Corporation; Fort Wayne, Indiana; 1992; p. 24.

² *Ibid.*, p. 24.

³ HEA 1001 (2002 Special Session)

⁴ HEA 1001 (2002 Special Session) Fiscal Impact Statement; Indiana Legislative Services Agency; Indianapolis, Indiana; June 13, 2002; p. 14.

A similar provision could be included to reduce or eliminate the taxation of tangible personal property.

The 2004 amendment to the Indiana Constitution had broader ramifications than just permitting the elimination of the inventory tax. The language had the effect of allowing the General Assembly to exempt “tangible personal property other than property being used as an investment.” This amendment appears to also have the breadth of scope to allow for the elimination of tangible business personal property from the tax base.

Who Pays Personal Property Taxes In Indiana?

About 290,000 Indiana businesses paid personal property taxes in 2013. These taxpayers paid a total of \$1,022 million in personal property taxes in 2013. The payments made by these firms showed extraordinary variation. The top 100 taxpayers paid 31 percent of total non-utility payments. These are large businesses including the familiar corporate names, such as Eli Lilly, British Petroleum, Chrysler, U.S. Steel and Toyota. The bottom 100,000 taxpayers with positive tax payments paid only \$2.5 million in total, about 0.3 percent of total non-utility payments. Tens of thousands of small businesses pay very little in personal property taxes.

Table 1 shows the distribution of locally assessed personal property in 2013. Utility property is assessed by the state and not included here, which is why total taxes add up to only \$765 million. About a quarter of personal property taxes are paid by utilities statewide. Among locally assessed properties, 22.7 percent have less than \$1,000 in personal property assessments. These 65,000 taxpayers remitted only \$500,000 in personal property taxes in 2013. More than half of all taxpayers had less than \$10,000 in personal property assessments. They paid \$4.6 million in personal property taxes in 2013. More than two-thirds of taxpayers had less than \$20,000 in personal property, and paid \$21.3 million in taxes.

Table 1: Taxpayers by Locally Assessed Personal Property

Local AV Less Than:	Percent of Taxpayers	PP Tax Paid, 2013 (millions)
\$1,000	22.7%	0.5
\$5,000	46.2%	4.6
\$10,000	58.2%	10.3
\$20,000	69.7%	21.3
\$50,000	82.2%	48.7
\$100,000	89.7%	84.8
All Taxpayers (Local)	100.0%	765.1*

*The amounts of tax paid and percentages are cumulative

The large variation in tax payments implies that small businesses complete and local assessors process tens of thousands of personal property tax forms that yield a tiny fraction of total tax payments. While no data exist, it is possible that these filing and processing costs exceed the tax revenue generated.

Research On Taxes, Public Services And Economic Development

Suppose that businesses choose locations based on potential profits. They would consider potential sales and costs in each location, and choose the one that was most profitable. Factors firms might consider include the availability of customers, the skills and pay of employees, the supplies of equipment and expertise, the availability of transportation, the level of police and fire protection—and taxes.

Studies of business location and investment seek results by comparing the choices that businesses actually made among locations with different tax rates and different levels of public services. The problem, of course, is that many other factors also differ among locations, including access to markets, employee pay, and availability of equipment and expertise. It is tricky to separate these influences from the effects of taxes and public services. As a result, many studies find that taxes and public services affect business location and investment. In contrast, many studies find that taxes and public services have no effect. This means that looking at just one study is not sufficient.

Fortunately, three fairly recent articles review more than a hundred studies of the effects of taxes and public services on business location, investment, employment and other measures of economic development. Fisher and Wasylenko each wrote articles for an issue of *The New England Economic Review* in 1997. Fisher reviewed what was known about the effect of public services on development, and Wasylenko looked at research results about taxation and development. More recently, Arauzo-Carod and coauthors reviewed the latest results about industrial firm location, in a 2010 article in the *Journal of Regional Science*.

Some businesses need to locate near potential customers, and that means locations with large populations and high incomes are favored. Businesses with national or international markets may not need to locate near their markets, however. Many manufacturing firms are in this category.

“Agglomeration economies” frequently are found to be important. This means that firms locate near other firms in the same industry. Silicon Valley’s technology businesses are an example. Locating near other similar businesses reduces the costs of hiring employees with experience in the industry, and of acquiring specialized equipment and expertise. Higher quality transportation infrastructure can attract development. The availability of highways, ports, rail systems and airports can reduce business costs, especially for manufacturing firms with wide markets. The availability of skilled employees can raise productivity. Costs are reduced if those employees can be hired for lower pay.

Taxes are shown to matter for development in more studies than not. Lower business taxes reduce costs and raise profits, which encourages business location and expansion. The

effect of taxes is small in most studies of multi-regional location, however. Differences in agglomeration economies, transportation infrastructure and employee skills and pay have bigger effects on costs and productivity than taxes. Taxes also matter less when all localities have similar tax rates. This implies that taxes matter more for jurisdictions with taxes much higher or much lower than their competitors.

Taxes matter more when a business is deciding among locations within a region. The firm's access to markets and employees will be the same for all locations within a region, but if there are multiple government jurisdictions, taxes and public services may differ. Research finds a larger effect of tax differences on business location and investment within a region, compared to decisions among regions.

Public services can affect business costs. Much of the transportation infrastructure is provided by government. Many studies show that jurisdictions with more highway spending or more highway miles attract more business investment. Some studies show that public safety expenditures matter. Better police and fire protection may reduce property loss and insurance costs. Skilled employees can raise productivity, and a few studies show that greater spending on education adds to development. Many studies show no effect for school spending, however. Perhaps this is explained by the long time required for education expenditures to produce skilled employees.

Tax cuts can decrease business costs, add to profitability, and so encourage firm location and new investment. They are most effective in competition with nearby jurisdictions in the same region. The effect of tax cuts on multi-regional firm locations is smaller. Tax cuts are most effective where they eliminate tax disadvantages relative to competing locations, or where they create relative tax advantages. And they are most effective where the loss of tax revenue to governments does not reduce public services, especially on highways, police and fire protection, and perhaps education.

Why Is There A Push For Reducing Or Eliminating The Personal Property Tax?

There are several arguments put forth for reducing or ending Indiana's taxation of personal property. These include both economic development related factors and tax equity issues.

Staying Competitive for Business Investment

Perhaps the most frequently heard argument is Indiana should eliminate the personal property tax to retain a competitive tax climate compared with our neighboring states. Both Illinois⁵ and Ohio⁶ have eliminated their personal property tax and Michigan has taken

⁵Illinois eliminated the personal property tax in 1979 and provided for replacement revenue to local units of government, see <http://tax.illinois.gov/LocalGovernment/Overview/HowDisbursed/replacement.htm>

⁶Ohio Department of Taxation website http://www.tax.ohio.gov/personal_property/phaseout.aspx "One of Ohio's most significant tax reforms in decades began in 2005, when the Ohio General Assembly launched a five-year phase-out of the tangible personal property tax with House Bill 66. This phase out, which was complete after 2008

several steps to phase out its personal property tax by 2022⁷. All three of these states enacted some form of replacement revenue to local governments to compensate for the elimination of their personal property tax. Kentucky continues to tax personal property but at a rate lower than Indiana's. The Tax Foundation Background Paper entitled "States Moving Away From Taxes on Tangible Personal Property" provides a good summary of how individual states treat the taxation of business personal property⁸. Included among the key findings from the Tax Foundation study were:

- Tangible personal property (TPP) taxes are now largely invisible to individuals but can be a significant tax expense for business.
- Seven states have entirely eliminated TPP taxation, and four have eliminated most TPP taxes. Per capita collections for TPP taxes dropped 20 percent between 2000 and 2009.
- States should not replace TPP taxes with a revenue source that is harmful to capital accumulation and economic growth.⁹

Don't Tax What You Want

A basic tenant of taxation is to "tax the things you don't want and don't tax the things you want." One of the traditional and continuing strengths of the Indiana economy is its manufacturing sector. Indiana leads the nation with the highest share of manufacturing employment per capita and has the highest manufacturing sector income share of total income.¹⁰ Critical to the continued strength of the state's manufacturing sector is its willingness to continue to reinvest in new equipment that facilitate increases in productivity. Yet Indiana has one of the highest effective property tax rates on commercial and industrial equipment across the country. In 2009 Indiana ranked as the sixth-highest for taxation of commercial equipment and third-highest for taxation of other industrial and machinery equipment, according to an Ernst and Young study prepared for the Council on State Taxation.¹¹ The recently released 2013 Indiana Manufacturing Survey by Katz, Sapper & Miller and the Indiana University Kelly School of Business emphasized the importance of taxation in investment decision-making as it "ranked property and corporate tax policy as the issues 'most critical in terms of the cost and viability of manufacturers in Indiana'."¹²

for nearly all general taxpayers, includes a system of direct payments from the state to schools and local governments in order to help offset the loss of property tax revenue."

⁷"Personal Property Tax Reform in Michigan: The Fiscal and Economic Impact of SB 1065-SB 1072"; prepared by Jason Horwitz, Senior Analyst and Alex Rosaen, Consultant with the Anderson Economic Group, LLC for the Michigan Manufacturers Association; East Lansing, Michigan; April 24, 2012; p. 1.

⁸"States Moving Away From Taxes on Tangible Personal Property" Background Paper Number 63; Joyce Errecart, Ed Gerrish, and Scott Drenkard; Tax Foundation; October, 2012.

⁹Ibid., p. 1.

¹⁰June 14, 2013 News Release by Conexus and Ball State University announcing the release of the 2013 Manufacturing and Logistics Report Card.

¹¹"Competitiveness of State and Local Business Taxes on New Investment"; prepared for the Council on State Taxation by Ernst & Young; authors Robert Kline, Andrew Phillips and Thomas Neubig; April, 2011; Table A-4.

¹²Pat Kiely, President of the Indiana Manufacturers Association letter to the editor in the Indianapolis Business Journal; January 4, 2014.

A Tax Based on Self-Assessment

Personal property in Indiana, as in other states, is essentially self-assessed. Property owners are required to annually determine the value of all taxable personal property under the rules set forth in the Indiana Administrative Code.¹³ As the Tax Foundation paper referenced above noted, the manner in which we assess personal property is “taxpayer active” compared with the manner in which real property is assessed as “taxpayer passive”¹⁴. The burden for establishing the accuracy of a personal property assessment falls on local and state assessment officials. Audits must be performed to determine the validity of a given assessment and the accuracy of the system depends, to significant extent, on the quantity and quality of such audits. Particularly in the case of taxpayers with relatively smaller amounts of personal property, this process of relying on audits may cost far more than the benefits it provides.

A Complex Reporting Process

The rules governing the annual reporting of personal property are quite complex and may be particularly burdensome for new and small businesses that are not equipped with the tax expertise or capacity to readily comply. As was illustrated earlier, the approximately 290,000 taxpayers filing annual personal property returns consist primarily of businesses with relatively small amounts of taxable personal property. As the Tax Foundation paper states, “While there is insufficient empirical data on how much time businesses spend filling out personal property forms, it is a burden that weighs most heavily on new business that must find and detail this information for the first time.”¹⁵

A Matter of Tax Equity between Businesses and Individuals

Another argument made in favor of reducing or eliminating the personal property tax is that of tax burden equity between individuals and businesses. There is some evidence that the 2008 tax reforms did shift the burden for financing local government from residential to business and commercial property. Between 2007 and 2011 property taxes paid by residential property declined by 15.9 percent while property taxes paid agricultural and business property increased 8.5 percent. The 2008 property tax reforms resulted in business picking up a larger percentage of all property taxes paid in Indiana (46 percent in 2007 and 53 percent in 2011).¹⁶ The substantial increase in the residential standard deduction and the Supplemental Homestead Deduction contributed to this shift as did the differentials in the property tax caps on residential (1 percent and 2 percent) compared with business property (3 percent).

Others contend that this comparison does not consider the reduction in business property taxes attributable to the elimination of inventory from the personal property tax base in the

¹³ Title 50 Indiana Administrative Code Article 4.2 Assessment of Tangible Personal Property, adopted under the authority of Indiana Code 6-1.1-3 Procedures for Personal Property Assessment.

¹⁴ “States Moving Away From Taxes on Tangible Personal Property” Background Paper Number 63; Joyce Errecart, Ed Gerrish, and Scott Drenkard; Tax Foundation; October, 2012; p. 5.

¹⁵ *Ibid.*

¹⁶ Property Tax Impact Report; Legislative Services Agency; Indianapolis, Indiana; December, 2009 and December, 2011.

2004-2007 time-frame. It should be noted that local government is increasingly supported by individual income taxes that are not paid by corporations (but do indirectly tax the earnings of non-corporate business entities, such as sole proprietorships, partnerships and LLCs).

The Difficult Issues: Tax Shifts And Revenue Losses

For much of the property tax, local units of government set their property tax rates by dividing the revenue to be raised (the levy) by the taxable assessed value of property. Operating levies are set by state controls and debt service levies are set by bond repayment schedules. Since these levies are usually not affected by changes in assessments, declines in assessed value cause tax rates to increase. If personal property were eliminated from the tax base, then, tax rates would rise and other property owners would pay higher tax bills. Taxes would shift from personal property owners to other taxpayers.

Taxpayers who are already at their property tax caps (also known as circuit breaker caps) would not pay added taxes with the higher rates. Some taxpayers would see their tax bills rise above their caps, and so would pay only a portion of the added tax. This means that some of the taxes currently paid by personal property owners would not shift to other taxpayers. Local governments would lose this revenue.

A few levies have fixed rates, such as those for cumulative funds or the school capital projects fund. For these funds a decline in assessed value reduces tax payments with no shift to other taxpayers. Personal property elimination would cause revenue losses for local governments.

The Dec. 23, 2013 memorandum from the Legislative Services Agency¹⁷ (LSA) provides estimates of tax shifts among property owners and the revenue losses for local governments. The estimates are for taxes in 2015.¹⁸ Total personal property taxes are estimated to be \$1,063 million, or just over \$1 billion. Of this amount, LSA estimates that personal property elimination would shift \$376 million to other taxpayers, increase tax cap credits by \$554 million, and decrease fixed-rate fund revenues by \$134 million. Net revenue losses to local governments would equal the sum of tax cap and fixed-rate fund losses, \$687 million. Of the approximately \$1 billion in personal property taxes, about two-thirds would be revenue lost by local governments, and one-third would be higher taxes for other taxpayers.

¹⁷ "Memorandum to the Members of the General Assembly Regarding the Elimination of Personal Property Assessments and the Elimination of the 30% Valuation Floor for Personal Property"; prepared by the Indiana Legislative Services Agency; Indianapolis, Indiana; December 23, 2013.

¹⁸ Ibid.

The Potential Shift Among Property Taxpayers

In the years before the enactment of the property tax caps/circuit breaker credits, eliminating the remaining taxable personal property from the property tax base would, in most cases, simply cause a shift of the property tax burden for financing local government from those owning personal property to those owning real property. In fact, such a shift occurred both with the elimination of inventories from the tax base in the mid-2000s and with the periodic increases in the Homestead Deduction and the enactment of the Supplemental Homestead Deduction.

If the taxation of personal property is reduced or eliminated, a shift will again occur, although it will produce a different outcome. The LSA memo offers estimates of this shift on a statewide basis. If the personal property tax were totally eliminated for taxes payable in 2015 (assessed as of March 1, 2014), then owners of homestead properties (generally owner-occupied homes) would experience a collective \$143 million increase; other residential properties would experience a \$33 million collective increase; the owners of apartments would experience a \$7 million increase; owners of agricultural real property (primarily land) would experience a \$55 million increase and owners of all other real property (primarily commercial and industrial land and buildings) would experience a \$138 million increase. The total shift to taxpayers is estimated at \$376 million in 2015. All of these estimates are made after the impact of circuit breaker credits is considered.

Statewide, 35 percent of the impact of eliminating the personal property tax is estimated to be absorbed by the shift in tax burden. The statewide average increase in homeowner property taxes is estimated to be 7.3 percent; the increase to other residential properties is estimated at 4.3 percent; the statewide increase to apartment owners is estimated at 2.5 percent; the estimated increase for agricultural real property statewide is 10.8 percent; and for all other real property the increase is estimated at 7.6 percent. Other real property is mostly business land and buildings. Businesses with only a small proportion of personal property in their total assessed value could see tax bill increases as a result of the shift. The differing property tax caps impact how this shift will affect each category of taxpayers.

Of course, the magnitude of the shifts would vary in each taxing district and county. Once again, the Legislative Services Agency memo provides some estimates by county for the 2015 shifts. The size of the tax shift in each county depends on the amount of personal property in the tax base and on how close taxpayers are to their property tax caps.

Table 2 provides evidence. It shows county by county average percent changes in tax payments for owners of real property, in counties with more or less personal property, and counties with more or fewer taxpayers at their caps. Real property owners see a 9.9 percent tax bill increase in the average county.

In total, in counties where personal property is less than 14 percent of net assessed value (NAV) real property owners see an average tax bill increase of 7.1 percent. Where personal property is 14 percent or more of the tax base, real property owners see an average

increase of 12.3 percent. Tax shifts are bigger where there is more personal property tax to shift.

Table 2. Average Real Property Tax Changes by County (LSA Estimates for 2015)

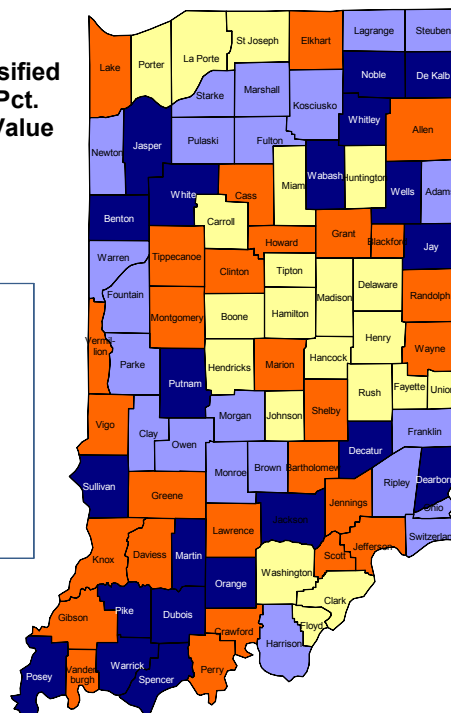
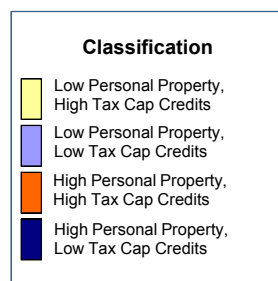
Personal Property Pct of NAV	Tax Cap Pct of Levy		All
	Less than 4%	4% or More	
Less than 14%	8.1%	6.0%	7.1%
14% or More	16.5%	9.2%	12.3%
All	12.2%	7.8%	9.9%*

*Represents the percentage increase of tax bill in the average county

Tax cap credits as a percent of the levy provide a measure of how close taxpayers are to their tax caps. In counties where tax cap credits are less than 4 percent of total levies, the average real property owner pays 12.2 percent in added taxes. Where tax cap credits are 4 percent or more of the levy, the tax hike is 7.8 percent. Tax bill increases are smaller in counties where more taxpayers have their taxes capped.

Map 1 shows counties based on the classification in **Table 2**. Counties with less than 14 percent of their assessments in personal property are lightly shaded (low personal property). Those with more than 14 percent are darker (high personal property). Counties with less than 4 percent of their levies lost to tax cap credits are shades of blue. Those with more than 4 percent are shades of orange.

**Map 1
Indiana Counties Classified
by Personal Property Pct.
in Taxable Assessed Value
and Tax Cap Credits
as a Percent of Levies**

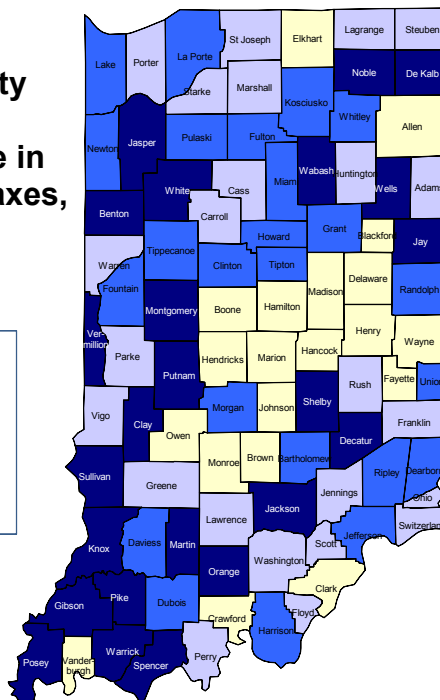
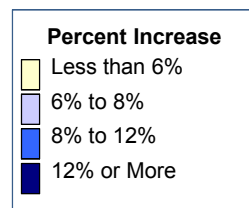


Counties in southwestern Indiana all have large shares of personal property, shown in darker colors. Some have many taxpayers at their tax caps (orange); some have few taxpayers at their tax caps (blue). Much of central Indiana is shaded orange, because these counties have many taxpayers at their tax caps. Some are dark orange, indicating large share of personal property in assessed value, while others are beige, indicating small personal property shares.

Indiana’s urban counties mostly are shaded darker orange. Lake, Allen, Marion and Vanderburgh have large amounts of personal property and many taxpayers at their caps. There are businesses with large amounts of personal property in many cities and towns. (Those four counties by themselves had 29 percent of all Indiana taxable personal property in 2013.) Likewise, cities and towns add an extra tax rate to what taxpayers pay, so more urban taxpayers receive tax cap credits. (Those four counties by themselves had 46 percent of all Indiana tax cap credits in 2013.)

Map 2 shows counties by the estimated percentage increase in real property taxes as a result of personal property tax elimination. The shadings of the two maps show the same pattern as in **Table 2**. Most counties in southwestern Indiana show large tax increases. These counties had large amounts of personal property taxes and much of it shifts to other taxpayers. But Vanderburgh shows only small increases in real taxes, because so many taxpayers are already at their caps. Taxpayers in many counties in central Indiana are estimated to see only small tax increases. These counties have many taxpayers at their caps, shaded orange in **Map 1**.

**Map 2
Personal Property
Tax Elimination:
Percent Increase in
Real Property Taxes,
Estimated 2015**



The Potential Impact On Tax Cap Circuit Breaker Credits

The elimination of personal property from the property tax base would increase tax rates. Higher tax rates would push more taxpayers above their tax caps. These taxpayers would be granted higher tax cap (circuit breaker) credits, so local governments would collect less of their property tax levies. The LSA memo estimates that local governments would lose \$556 million in revenue to added tax cap credits, which would be an additional 6 percent of the statewide tax levy. Total tax cap credit revenue losses are estimated to increase from \$825 million to \$1.4 billion. Cities and towns would lose the most revenue, \$175 million. School corporations would lose an estimated \$151 million, counties \$71 million, and all other units, including tax increment financing (TIF) districts, \$159 million.

Again, two factors are most important in determining tax cap credit losses: the importance of personal property in the tax base and the share of the levy already lost to tax cap credits. **Table 3** shows county-by-county average percent changes in added tax cap credit losses, in counties with more or less personal property, and counties with more or fewer taxpayers at their caps. Local governments in the average county lose an added 6 percent to credits with personal property tax elimination.

Table 3. Added Tax Cap Credit Losses, Percent of Levy (LSA Estimates for 2015)

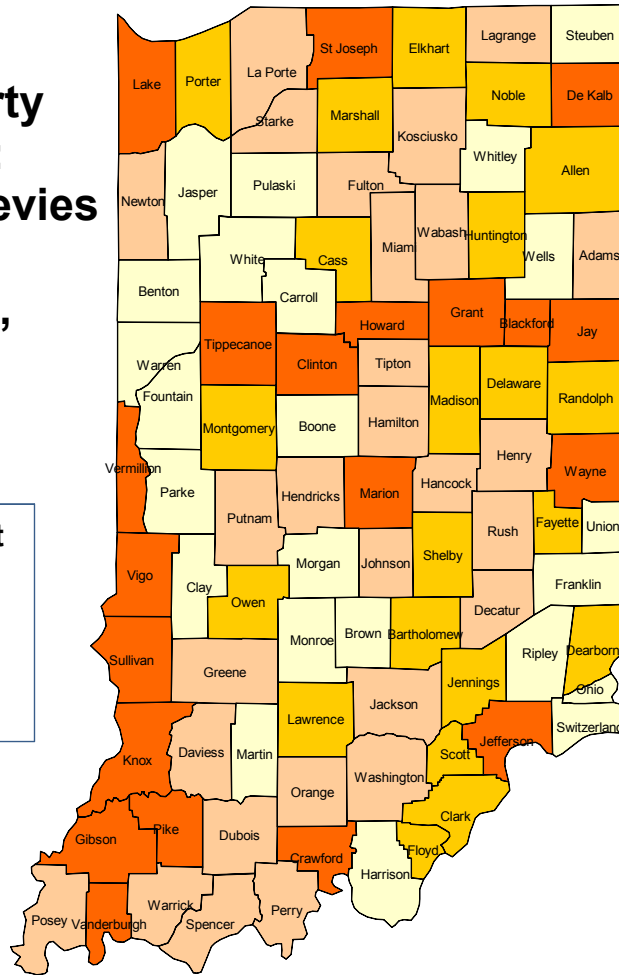
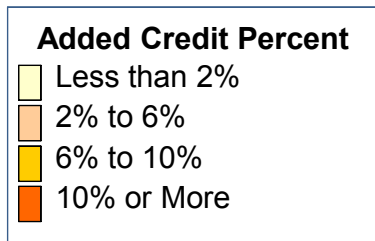
Personal Property Pct of NAV	Tax Cap Pct of Levy		All
	Less than 4%	4% or More	
Less than 14%	1.8%	5.3%	3.5%
14% or More	5.5%	10.4%	8.3%
All	3.6%	8.2%	6.0%

Where personal property is less than 14 percent of net assessed value local governments lose an added 3.5 percent of their levies to tax cap credits. Where personal property is 14 percent or more of the tax base, the loss averages 8.3 percent. Revenue losses are bigger where there is more personal property tax to lose.

In counties where tax cap credits are less than 4 percent of total levies, the average added loss to tax cap credits is 3.6 percent of the levy. Where tax cap credits are 4 percent or more of the levy, the average loss is 8.2 percent. Added tax cap credit losses are larger where more taxpayers have their taxes capped already.

Map 3 shows counties by estimated added tax cap credit losses. This can be compared to **Map 1**. The counties in southwestern Indiana with large amounts of personal property and higher current tax cap credits—shaded orange in **Map 1**—show larger levy losses in **Map 3**. Lake, Marion and Vanderburgh have losses of more than 10 percent; Allen loses 9 percent. Losses are smaller in many central Indiana counties, with less personal property, and many rural counties, with few taxpayers at their caps.

Map 3 Personal Property Tax Elimination: Percent of All Levies Lost to Added Tax Cap Credits, Estimated 2015



The Impact On Rate Controlled Funds

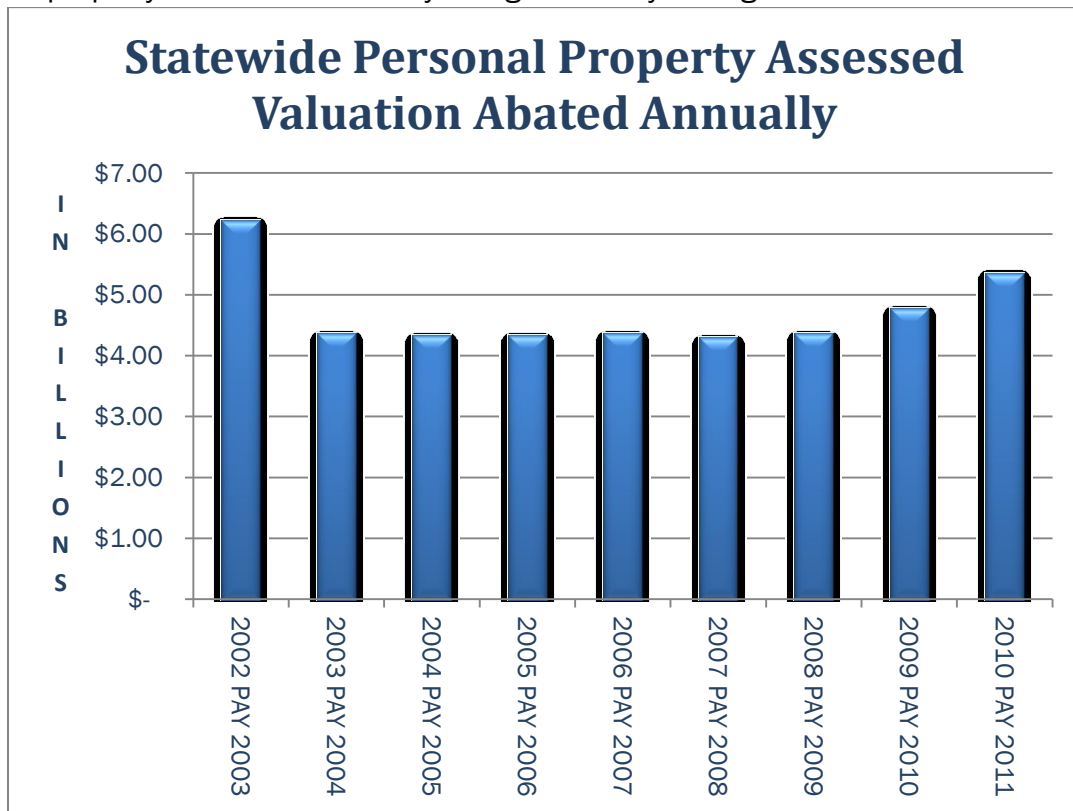
As noted above, most property tax supported local government funds have levy controls placed upon them by Indiana legislation.¹⁹ There are also a few funds, such as school corporation Capital Projects Funds and county and municipal Cumulative Capital Development Funds, which are rate-controlled funds. In these cases the annual property tax rate that can be charged is set by state legislation and the amount to be raised will vary depending on the assessed valuation in the taxing area. If personal property is removed from the tax base of these funds, the amount which can be raised will be reduced. The LSA

¹⁹ Indiana Code 6-1.1-18 and 6-1.1-18.5

and the authors of this report estimate that statewide rate-controlled funds collective levies will be reduced by \$134 million in 2015 (after factoring the Circuit Breaker impact).²⁰ This would be an estimated 15 percent reduction in rate controlled funds statewide.²¹

Local Tax Abatements Already Deduct Approximately 10 Percent Of The Personal Property Tax Burden

While tax abatements in Indiana began as an urban renewal tool in 1977, today they are used much more frequently as a job retention and creation incentive by local governments (counties and municipalities). Indiana Code 6-1.1-12.1 authorizes the phase-in of the property tax burden on new real property investments and most personal property investments. It is actually the incremental growth in assessed valuation that is deducted from the respective property owner’s annual gross assessment. In 2011, \$5.4 billion of personal property assessed value was abated, accounting for 11.4 percent of gross assessed value of personal property statewide.²² Thus, a little more than 10 percent of all personal property in Indiana is already being abated by local governments.



²⁰ “Memorandum to the Members of the General Assembly Regarding the Elimination of Personal Property Assessments and the Elimination of the 30% Valuation Floor for Personal Property”; prepared by the Indiana Legislative Services Agency; Indianapolis, Indiana; December 23, 2013.

²¹ Ibid.

²² “Report on Property Tax Exemptions, Deductions, and Abatements”; Indiana Department of Local Government Finance; Indianapolis, Indiana; April 30, 2012; Table 28. The above chart also includes data from the 2008 and 2010 reports.

In 2011 the General Assembly significantly altered the property tax abatement process when it enacted the “alternative abatement schedule” language (IC 6-1.1-12.1-17)²³. The new “super abatement” allows local jurisdictions to grant up to 100 percent abatement of real and personal property for up to 10 years. While it is too soon to understand the complete ramifications of this modification, historical indications on the use of other tax incentives indicates that it will likely be used sparingly over the next few years. However, competition among counties and pressure from applicants may well encourage a wider use of the full 100 percent, 10-year abatement of personal property over the longer term. It should be noted that Indiana Assessment Depreciation Pool #1 runs four years and Pool #2 runs seven years, meaning a local jurisdiction using a 100 percent abatement schedule more than seven years on personal property in either of these two pools would only be abating the 30-percent floor assessment. Should there be no other changes in the taxation of personal property over the next few years, it will be interesting to follow the impact of the “super abatement” legislation.

A Significant Portion Of Net Personal Property Assessed Valuation Is Used To Support Tax Increment Financing Districts

Counties and municipalities, through their respective redevelopment commissions, have been able to “capture” property assessments and corresponding property tax revenues in Urban Renewal Areas and Economic Development Areas (IC 36-7-15.1 for Marion County and IC 36-7-14 elsewhere in Indiana).

Redevelopment Commissions have the ability to capture the real property assessed value on new development and on personal property assessed value increases in these selected areas through the TIF process. Early in the history of TIF, it was much more common for commissions to capture only real property assessed value increments. However, over the past decade the capture of personal property assessed valuation has become much more common. For example, in 2003 2.3 percent of net personal property was captured by TIF districts. By 2013, the \$2.8 billion in personal property assessed valuation captured in TIF districts represented 6.55 percent of all net personal property statewide²⁴.

Based on the December 23, 2013 memorandum to the General Assembly prepared by the Legislative Services Agency, TIF district proceeds are estimated to be reduced by approximately \$39 million in 2015 if the personal property tax is total eliminated. By comparison, in 2013 \$547.5 million in net property taxes were captured by the 649 TIF districts across the state.²⁵ Of course, the impact on individual TIF districts will vary considerably depending on the proportion of their respective increment that is collected from the tax on personal property.

²³ P.L. 173 – 2011 / HEA 1007 (2011) / IC 6-1.1-12.1-17

²⁴ “Memorandum to the Commission on State Tax and Financing Policy Regarding Tax Incrementing Financing by Taxing District”; prepared by the Indiana Legislative Services Agency; Indianapolis, Indiana; November 18, 2013.

²⁵ Ibid.

Much of this captured personal property assessed valuation and the corresponding property tax revenue accruing to the redevelopment commissions has been pledged to repay outstanding financial commitments made by the respective commissions. These commitments include a full range of financing tools, including bond issues and payback agreements to companies as a part of an incentive package used to induce their investment within the respective TIF district. Should the personal property tax be reduced or eliminated, it will be necessary to establish a replacement revenue stream to the respective redevelopment commissions to avoid potential situations of default on outstanding commitments.

In 2008, the General Assembly gave redevelopment commissions and local governments the ability to take several different actions to increase the property tax revenues to offset TIF revenue losses due to the property tax caps. If TIF revenues in an allocation area have been decreased by a law enacted by the General Assembly or by an action of the DLGF below the amount needed to make all payments on obligations payable from tax increment revenues, the governing body of the TIF district may: (1) impose a special assessment on the owners of property in an allocation area; (2) impose a tax on all taxable property in the TIF district; or (3) reduce the base assessed value of property in the allocation area to an amount that is sufficient to increase the tax increment revenues.²⁶

This provision may have further application if the personal property tax is subsequently reduced or eliminated. Indiana Code 6-1.1-21.2-11 states these alternatives are applicable if:

- (1) laws enacted by the general assembly; and
- (2) actions taken by the department of local government finance; after the establishment of the allocation area have decreased the tax increment revenues of the allocation area for the next calendar year (after adjusting for any increases resulting from laws or actions of the department of local government finance) below the sum of the amount needed to make all payments that are due in the next calendar year on obligations payable from tax increment revenues and to maintain any tax increment revenue to obligation payment ratio required by an agreement on which any of the obligations are based.

A reduction of the amount of personal property that is taxable would certainly appear to give local units several alternatives to protect themselves from potential default on outstanding TIF obligations backed by personal property taxes.

The Potential Impact On Indiana's Enterprise Zones

The Indiana General Assembly established the Enterprise Zone program (I.C. 5-28-15) with the intent of stabilizing existing and simulating new investment and jobs in areas of cities that were economically distressed. Former military installations were later added as eligible

²⁶ House Enrolled Act 1001 (2008) Sections 231-241.

areas under the legislation. As of 2012 there were 21 enterprise zones and 3 closed military bases approved across the state.²⁷

One of the key features of the original Enterprise Zone program was the total exemption of taxation on inventory stored in the respective zones. When the inventory tax was eliminated, the General Assembly replaced that deduction with the Enterprise Zone Property Tax Investment Deduction that allows for up to a 100 percent deduction of certain new real and personal property assessments for a period of up to 10 years. Among the investments eligible for this deduction are new manufacturing and production equipment; new computers and related office equipment; and the costs associated with retooling existing machinery. This Investment Deduction went into effect on July 1, 2005. Nearly \$200 million of personal property assessment was collectively deducted in 2011 (Pay 2012) from 15 different enterprise zones and one closed military installation.²⁸ In addition to the benefit to zone businesses, enterprise zone governing organizations may require zone businesses to share a percentage of their tax savings with the local enterprise zone organization to fund projects that benefit the zone.

The significant reduction or elimination of the personal property tax would negatively impact enterprise zones in two ways. First it would remove one of the unique tax incentives available to encourage investment within Indiana's zones. However, enactment of the "super abatement" has already diminished this advantage of investing within a zone. Second, to the extent that zone organizations depend upon the sharing of taxing savings to fund their respective programs, enterprise zone organizations would again be faced with a potential reduction in one of their key financing mechanisms.

A Short-Lived Experiment: The Indiana Business Investment Deduction

In 2005 the General Assembly enacted a new program that could serve as a model of the reduction of the personal property tax burden.²⁹ The "Indiana Business Investment Deduction" was an experiment to provide a more simplified reduction of real and personal property tax burden on new investments. It was originally to last for four years, applicable to assessments on March 1, 2006 through March 1, 2009. It did require both new real or personal property investment and the retention or creation of jobs. The program allowed the deduction of 75 percent of the new assessed valuation in the first year, 50 percent in the second year, and 25 percent in the third, and final, year. Each property owner would be limited to \$2M assessed valuation (AV) in real property deductions plus \$2M AV in personal property deductions within each county.

In 2007, as part of negotiations over that year's budget bill, the General Assembly eliminated the last two years of the program. Over its brief life, the Indiana Business Investment Deduction resulted in the reduction of \$818 million in statewide personal

²⁷"Indiana's Geographically Targeted Development Programs: Enterprise Zones"; Indiana Legislative Services Agency Fiscal Policy Brief; July 1, 2012.

²⁸ Ibid.

²⁹ Senate Enrolled Act 1 (2005)

property assessed valuation for taxes payable in 2007; \$1.6 billion in 2008; \$1 billion in 2009; \$374 million in 2010; and \$20 million in 2011.³⁰

Recent Legislative Initiatives

As noted in the section on tax abatement, legislative efforts in Indiana to directly or indirectly reduce the taxation of business personal property date back to at least 1977. While the personal property tax was not a major item of consideration during the 2007-2008 tax restructuring efforts that ultimately led to HEA 1001 (2008), there has been renewed General Assembly interest in the personal property tax during recent legislative sessions.

In 2011, SB 271, as introduced, would have allowed a county, city or town (or in the case of Marion County, its Metropolitan Development Commission) to fully or partially exempt personal property from property taxation. The exemption would have been for only personal property located within the respective unit's boundaries (the unincorporated territory in the case of county council adoption of the exemption). The bill also would have allowed taxpayers to make payments in lieu of taxes (PILOTs) to local governments up to an amount of the exempted tax burden.³¹ The bill was ultimately assigned to the Senate Committee on Tax and Fiscal Policy, where it died. The bill did introduce into the discussion the concept of a county-by-county option on the elimination of the personal property tax.

In 2012 SB 229 was introduced. This proposal would have allowed individual counties to exempt business personal property from the tax base. The decision to exempt personal property in a given county fell first to the respective county council, and if it took no action, then to the voters through a local public question (referendum) if petitioned by at least 2 percent of the county's voters. To provide an adopting county with offsetting revenue, 5 percent of the state sales tax collected in the applicable county would be redirected to the county and ultimately to its property tax supported units. The 5 percent of sales tax collections from the given county could result in either more or less revenue than the revenue lost to those units due to the exemption. If all counties would have adopted the personal property exemption option proposed in this bill, the Fiscal Impact Statement on the bill estimated that approximately \$356.5 million in state sales tax revenue would be diverted from the state to local governments in FY 2014.³² The bill was assigned to the Senate Committee on Tax and Fiscal Policy where it died. It did introduce into the discussion the concept of substantial state financial support to offset the local government revenue lost due to the exemption of personal property. It also reinforced the concept of a local option on the exemption as was first considered in the 2011 bill discussed above.

³⁰ "Report on Property Tax Exemptions, Deductions, and Abatements"; Indiana Department of Local Government Finance; Indianapolis, Indiana; April 30, 2012.

³¹ SB 271 (2011) Fiscal Impact Statement #3; Legislative Services Agency; Indianapolis, Indiana; February 8, 2011.

³² SB 229 (2012) Fiscal Impact Statement #1; Legislative Services Agency; Indianapolis, Indiana; December 28, 2011.

Two bills related to the personal property tax were introduced in the 2013 session of the General Assembly. SB 375 proposed to modify the minimum personal property depreciation floor from 30 percent to 20 percent. The Fiscal Impact Statement on this bill estimated that the reduction in the depreciation floor would have eliminated about \$8.4 billion in business personal property assessed valuation statewide in 2015, and a reduction of approximately \$253 million in property taxes paid on personal property. This would have resulted in an estimated shift of about \$74 million in property taxes and an estimated increase in Circuit Breaker credits of approximately \$166 million.³³ The bill was assigned to the Senate Committee on Tax and Fiscal Policy where it died. This bill introduced yet a third item into the personal property tax discussion, that of lowering (or eliminating) the current depreciation floor of 30 percent.

Lastly, HB 1530 proposed an exemption from taxation for all new personal property beginning with the March 1, 2014 assessment located in all counties that had not taken specific action to opt out of the exemption. The bill limited the exemption to the first \$100,000 of a taxpayer's new personal property. If no counties opted out of the exemption, the Fiscal Impact Statement estimated that approximately \$1.07 billion in personal property assessed value would be exempted in 2015. The \$100,000 limit would capture about 35 percent of new personal property assessed valuation³⁴. This bill was assigned to the House Committee on Ways and Means where it died. It did introduce the concept of the exemption applying to only new personal property and of arbitrarily limiting the amount of a taxpayer's personal property that would qualify for the exemption, which are similar to concepts Michigan enacted.

While none of these proposals moved out of their assigned committees, they do give us a glimpse of concepts that were introduced and had Fiscal Impact Statements prepared.

What If The 30-Percent Floor On Personal Property Depreciation Is Eliminated?

An unusual provision of the rules for assessing personal property is the 30-percent floor. Indiana Administrative Code Title 50, Article 4.2-9 states that “notwithstanding the foregoing provisions of this rule, the total valuation of a taxpayer's assessable depreciable personal property in a single taxing district cannot be less than thirty percent (30%) of the adjusted cost of all such property of the taxpayer.” No matter if the personal property is nearly or totally depreciated, the taxpayer's total personal property tax liability will not fall below 30 percent of the cost of the taxpayer's taxable personal property located within a specific taxing district.

The authors of this paper could not determine the origin of this provision. The 30 percent floor appears to be an arbitrary factor designed to ensure that owners of personal property continue to pay property taxes to local units of government regardless of the age or

³³ SB 375 (2013) Fiscal Impact Statement #3; Legislative Services Agency; Indianapolis, Indiana; January 16, 2013.

³⁴ HB 1530 (2013) Fiscal Impact Statement #1; Legislative Services Agency; Indianapolis, Indiana; January 10, 2013.

depreciated value of their personal property. A straightforward measure to reduce the impact of the personal property tax would be to simply remove the 30-percent floor from the Administrative Code.

This is an action that would have to be taken by the General Assembly rather than the Department of Local Government Finance. One component of the 2002 Property Tax Restructuring legislation included the adoption of I.C. 6-1.1-3-22 providing that the personal property assessment rules in effect on Jan. 1, 2001 shall be reinstated, shall remain in effect and shall not be amended by the Department. As noted in the prior section, legislation introduced in the 2013 session would have dropped the floor to 20 percent. A similar proposal could direct the Department of Local Government Finance to completely remove the floor provision from the Administrative Code.

Other Options For Mitigating The Personal Property Tax

In addition to the total exemption of personal property from the tax base or the elimination of the 30-percent floor, there are many other options for reducing or phasing out the personal property tax.

Exempting New Personal Property

The assessed valuation of any new personal property could be exempt from taxation, which would gradually phase-in a nearly total exemption over a number of years. We do not have access to the breakout of current personal property by depreciation pool, but theoretically an exemption of any new personal property would reduce the level of total assessed valuation on personal property to the 30 percent of cost floor by the end of the longest (13 year) Pool #4 depreciation schedule. If this option were coupled with an elimination of the 30 percent depreciation floor, then Indiana could reach a total exemption of personal property in approximately 13 years. Michigan included elimination of all new manufacturing personal property as one component of its effort to phase out its personal property tax.³⁵ One downside of this choice is that it unequally favors the taxpayer with new equipment compared with those that have a higher percentage of existing equipment. Some contend that the current tax abatement process involves the same unfair treatment.

Cap The Amount of a Taxpayer's Personal Property Exemption

A second alternative would be to exempt an arbitrary amount of personal property owned by each taxpayer in the state, a given county or a given township. If the threshold were relatively low, this option would favor smaller businesses. This option would substantially reduce the negative tax shift and the loss of much revenue to local units of government through circuit breaker credits as the amount of total personal property assessed valuation exempted would be much less than a total elimination. This alternative is similar to that proposed in Senate Bill 1 in the 2014 session of the General Assembly. SB 1 would “exempt small businesses from personal property tax liability if they have less than \$25,000 of

³⁵“Personal Property Tax Reform in Michigan: The Fiscal and Economic Impact of SB 1065-SB 1072”; prepared by Jason Horwitz, Senior Analyst and Alex Rosaen, Consultant with the Anderson Economic Group, LLC for the Michigan Manufacturers Association; East Lansing, Michigan; April 24, 2012; pp. 17-18.

personal property in a county. This change is projected to exempt up to 71 percent of business personal property tax filers.”³⁶ The Michigan personal property elimination program included a similar measure, exempting all industrial and commercial personal property at firms that owned less than \$40,000 of such personal property.³⁷

Local Option for Elimination of the Personal Property Tax

A third alternative would be to allow individual counties the option of eliminating all or some portion of the personal property tax. This alternative allows each county to determine its appropriate balance between the potential economic development benefits of reducing or eliminating the tax on personal property with the loss of revenue associated with increased circuit breaker credits and the shift of tax burden to other taxpayers. As the analysis provided earlier in this report shows, these impacts would be different in each county. On the negative side of the ledger, this alternative has the potential to pit county against county. Tax differences within regions can have large effects on firm location. This is particularly disconcerting as we are taking meaningful steps in this state to promote a regional approach to economic development. A second difficulty is determining which body makes the determination for a given county – is it the county income tax council (the group that made the decision on the early elimination of the inventory tax), the county council, or individual municipalities and county governments (for unincorporated areas). The latter could result in a complex system of tax accounting, both for local government and for taxpayers. House Bill 1001 being considered during the 2014 session is a variation on this local option theme, allowing for the exemption of new personal property. ³⁸

Different Tax Rates For Real And Personal Property

A fourth alternative would be to allow or mandate local units to set a different, and lower, property tax rate for personal property than is set for real property. This alternative would hinge on interpreting the recent amendments to Article 10 of the Indiana Constitution to allow for such a property tax classification system. This would, of course, be a significant departure from the original “uniform and equal” standard. For example, the tax rate on net personal property assessed valuation could be set at 50 percent of the tax rate on real property. This would obviously lower (1) the burden on owners of personal property, (2) the shift of tax burden to other taxpayers, and (3) the circuit breaker credits and thus the loss of revenue to local governments. It would treat all personal property equally but certainly would create a large gap in the treatment between real and personal property.

³⁶Senate Republican News Release; Statehouse; Indianapolis, Indiana; January 9, 2014; <http://www.indianasenaterepublicans.com/news/2014/01/09/2014/president-pro-tem-long-sens.-hershman-kenley-introduce-bill-to-reduce-taxes-on-hoosier-employers/> .

³⁷“Personal Property Tax Reform in Michigan: The Fiscal and Economic Impact of SB 1065-SB 1072”; prepared by Jason Horwitz, Senior Analyst and Alex Rosaen, Consultant with the Anderson Economic Group, LLC for the Michigan Manufacturers Association; East Lansing, Michigan; April 24, 2012; p. 17.

³⁸House Republican News Release; Indianapolis, Indiana; January 9, 2014; <http://www.insideindianabusiness.com/newsitem.asp?ID=63107> .

Options For Mitigating The Loss Of Revenue To Local Government And The Property Tax Shifts

A second set of alternatives focuses on how the loss of revenue to local governments is treated. As noted by the Dec. 23 LSA memo and earlier sections of this report, under total elimination the property tax cap losses are substantial. Indeed, the potential for these losses has created much of the opposition to proposals to eliminate the personal property tax. There are two primary ways to offset these revenue losses. One is for the state to create a replacement revenue stream from state resources. The other is to allow local units to make up all or a part of the loss through shifting the burden to other taxpayers (such as through the use of Local Option Income Taxes).

The Do Nothing Alternative

Of course, one alternative is for the state to do nothing. It creates no pressure on state resources and does not require the General Assembly to reallocate existing resources or to increase another tax to fund the replacement revenue. Some contend the increased economic growth that would be stimulated by eliminating the personal property tax will, over time, at least partially replace the lost revenue through increases in real property assessed values. Economic growth could be limited, however, if revenue losses result in reduced public services that businesses may value, such as highway, public safety or education.

A State Funded Replacement Credit

Another alternative would be for the state to implement a personal property tax replacement credit in which the state would fund some, or all, of the personal property tax burden on behalf of the taxpayer. Of course, the state would have to fund this credit and the full value is estimated to be in excess of \$1 billion in 2015. That is a huge revenue impact for the state to assume. If personal property tax elimination encourages development, state revenues could increase enough to partially offset this new burden. A second disadvantage is that none of the personal property tax filing requirements would disappear.

SB 229, in 2012, suggested that 5 percent of state sales tax revenue attributable to a given county could be redirected to that county as an offset to revenue lost from the elimination of the personal property in that county. This proposal did not suggest any increase in the state sales tax revenue or any other increase to compensate for the state's revenue loss.

Create A New Tax On Business To Provide Offsetting Revenue

A new state tax on business could be enacted to fund the replacement credit, similar to the automobile excise tax, which was created when vehicles were removed from the personal property tax base. However, Indiana has have been reducing, not increasing, the state tax burden on business. For example, the Corporate Income Tax is being reduced from 8.5 percent to 6.5 percent (and potentially to 4.9 percent as proposed in SB 1).

Create A New Local Option Income Tax

Lastly, yet another local option income tax could be established to allow local governments to (a) raise new money to offset the revenue loss from increased circuit breaker credits associated with eliminating the personal property tax and/or (b) provide credits to some or

all taxpayer groups to offset the shift in tax burden (similar to the CEDIT Homestead Credit allowed when the inventory tax could be eliminated early by county option).

Clearly, there are many options available to the General Assembly should it choose to reduce or eliminate the taxation of personal property. The above options are not an exhaustive list.

What Might Local Governments Do If The Tax Is Eliminated?

Should the personal property tax be eliminated without provisions for offsetting replacement revenues, what might be the reaction of local governments? As was detailed previously, this is likely to depend upon the particular conditions in each county. Where there is a significant shift in tax burden, there may be increased pressure on local officials to consider adopting or increasing the Property Tax Relief LOITS. In counties where there are significant increases in Circuit Breaker Credits, local officials may look to adopting or increasing either the Public Safety LOIT or the Property Tax Relief LOITs to at least partially compensate for the revenue losses.

The Dec. 23 LSA memo provides a county-by-county estimate of the local income tax rate increase that would be necessary to replace the taxes now being generated by the personal property tax. The statewide average income tax rate needed to replace all personal property in 2015 is estimated to be 0.77 percent. The estimated rate, however, varies greatly from county to county, with a high of 2.78 percent in Spencer County to a low of 0.10 percent in Brown County.³⁹

Adoption of local income tax increases would represent a further shift in how we finance local government away from the property tax and more toward the local individual income tax. A defacto result of eliminating the personal property tax might well be a substantial shift in who pays to support local government with more dependence on individuals and less on business.

Is The Elimination Of The Personal Property Tax Primarily An Economic Development Proposal?

We have had procedures in place in Indiana since the late 1970s allowing local governments to reduce taxation of personal property on most types of business equipment (originally manufacturing equipment and more recently other selected categories). The primary reason local governments grant tax abatements is to induce businesses to create or retain jobs. One could certainly argue that if a partial and temporary reduction of taxing personal property is good, then a wider and more permanent reduction, or total elimination, should be an even greater economic stimulus.

³⁹“Memorandum to the Members of the General Assembly Regarding the Elimination of Personal Property Assessments and the Elimination of the 30% Valuation Floor for Personal Property”; prepared by the Indiana Legislative Services Agency; Indianapolis, Indiana; December 23, 2013, p. 3.

However, it is very difficult to isolate what factors lead to business job retention and creation. Many studies have been undertaken intended to determine the direct relationship between tax incentives and job creation. Perhaps the most recent study in Indiana was undertaken by the Ball State University Center for Business and Economic Research entitled “Local Tax Abatement”.⁴⁰ Among the results of this study include: “We report findings that suggest that, as a job creation tool, local tax incentives in Indiana appear to be minimally effective. We also report that there is not a strong relationship between abatements and the growth of assessed value over time. The implication is that, on average, the use of abatements as a tool for growing a property tax base is not particularly effective in the short to intermediate term.”⁴¹

Another bill introduced in the 2014 session is HB 1020. If enacted, this bill would establish a five-year study of all tax incentives offered by both state and local government in Indiana. If this legislation moves, and if the primary argument for eliminating the personal property tax is job creation, perhaps the question of how to handle the taxation of personal property should also be included in this study, proposed to be undertaken by the Commission on State Tax and Financing Policy.

Is The Elimination Of The Personal Property Tax Primarily A Taxation Policy Proposal?

The elimination of personal property from the tax base was not seriously considered as a part of the much broader state and local government finance reforms of 2008. If it had, it is likely replacement revenue for local governments would also been a part of that discussion.

Business interests argue the combination of the differing property tax caps on homesteads (1 percent of gross assessed valuation; 2 percent on other residential property and agricultural land; and 3 percent on non-residential real property and personal property) were inherently unfair to the owners of business real and personal property. They point out the substantial assessments provided to homestead residences (the increased Standard and the creation of the Supplemental Homestead deductions) arbitrarily increased effective tax rates on business property. According to LSA, between 2007 and 2011 property taxes paid by residential property declined by 15.9 percent while property taxes paid by agricultural and business property increased 8.5 percent. The 2008 property tax reforms resulted in business picking up a larger percentage of all property taxes paid in Indiana (46 percent in 2007 and 53 percent in 2011).⁴² Others are as ready to point out that business interests substantially benefited when inventory was removed from the tax base in the mid-2000s, reducing the statewide annual assessed valuation by approximately \$ 17.1 billion. They

⁴⁰ “Local Tax Abatement”; Center for Business and Economic Research, Ball State University; Michael J. Hicks, PhD and Dagny G. Faulk, PhD; Muncie, Indiana; December, 2013; <http://projects.cberdata.org/75/local-tax-abatement>

⁴¹ Ibid., p. 7.

⁴² Property Tax Impact Report; Legislative Services Agency; Indianapolis, Indiana; December, 2009 and December, 2011.

also point to continued increases in local option income taxes, which are paid primarily by households.

It is probably impossible to find the magical balance of tax burden between business and non-business property owners. However, if the primary argument for eliminating the personal property tax is equity, then the issue should include a more comprehensive analysis of the appropriate overall tax burden than just the isolated action to eliminate or substantially reduce the taxation of business personal property.

Concluding Thoughts

If not for the property tax caps, consideration to reduce or eliminate the personal property tax would be primarily questions of (1) tax “equity” between and among categories of taxpayers—upon whom should the burden of funding much of local government fall?; and (2) balancing the property tax structure’s economic development ramifications with the desire to promote and protect homeowners. Of course, there would still be a number of relatively lesser issues such as protecting TIF district obligations from potential default on some personal property tax backed obligations; resolving the impact on rate-controlled funds; and determining what, if any, replacement incentives should be provided to Indiana’s enterprise zones. As this paper has noted, these are all issues that the General Assembly has previously dealt with in the past decade and could certainly resolve once again.

However, the Circuit Breaker revenue losses to local governments make this a much more complicated issue. Because the property tax caps are now in the Indiana Constitution, dealing with the Circuit Breaker losses is the reality that the General Assembly must face if it is to substantially reduce or eliminate the personal property tax.

One could argue that the enhanced economic development climate created by eliminating business equipment taxation would, over time, lead to increases in real property assessed value and increased personal income that may offset the Circuit Breaker losses to local governments. Research on the effects of taxes on development is not precise, but most studies find the effects to be relatively small. The associated reductions in public services valued by businesses might also limit the effects on development. Linking economic growth to a single factor or variable is no easy task. For example, there is scant empirical evidence that directly relates economic growth to the elimination of the tax on inventory in Indiana. Secondly, additional economic growth that might be directly related to the elimination of the personal property tax would take a number of years to be realized, but the Circuit Breaker losses to local governments would occur immediately.

One could argue that local governments should “just tighten their belts” to accommodate a more business-friendly tax climate in Indiana. Many local governments are still in the process of readjusting their budgets and revenue streams to adjust to the revenue losses as a result of the property tax caps/Circuit Breaker. The losses under existing law are estimated to exceed \$800 million in 2015 and the elimination of the personal property tax would add an additional \$550 million in losses statewide, plus an additional \$134 million in

reductions to rate controlled funds. Those numbers are significant and, in most jurisdictions, will not easily be accommodated with either increased taxes and users fees or reductions in local services.

Another approach would rely upon the use of revenue options for local governments, such as new increases in local option income taxes and more reliance on user fees, to offset the property tax revenue lost if the personal property tax is reduced or eliminated. Indeed, many counties still have room under existing law to use such measures. However, there are political concerns that while the General Assembly could take credit for reducing taxes, the burden of raising the offsetting revenue would fall entirely upon local elected officials. Additionally, user fees are far more applicable to some units of local government than others. Schools are particularly hard-pressed to look to user fees to replace property tax reductions. Secondly, the decision-making structure for approval of local income taxes is complex in many counties and leaves little meaningful role for many jurisdictions that would be affected by revenue declines. Lastly, the majority of existing alternatives for raising revenue locally will fall on individuals rather than businesses – and could represent yet another shift of the tax burden.

None of the above approaches leads to a clear path for implementing a reduction or elimination of the personal property tax. A reduction or elimination would improve the economic development climate in Indiana to some undetermined degree, but the property tax caps have created a dilemma. Does the General Assembly take the risk of improving the tax climate for business and change the balance of the tax burden between business and individuals at the expense of both individuals and local government? Or does the General Assembly take little or no action on the personal property tax to protect local governments from further property tax revenue losses and not create increases in residential property taxes? Most local government revenue losses tied to the reduction or elimination of the personal property tax will be offset by other local government revenue increases, either directly or indirectly. The key is finding the common ground between the interests of the business community and local elected officials, with the General Assembly serving as the mediating party. To reach a successful outcome, political credit for tax reductions and political blame for offsetting tax increases must be shared by both the General Assembly and by local elected officials.

Bibliography

“Competitiveness of State and Local Business Taxes on New Investment”; prepared for the Council on State Taxation by Ernst & Young; authors Robert Kline, Andrew Phillips and Thomas Neubig; April, 2011.

“Comprehensive Assessed Value Report 2010-2012 (Taxes Payable 2011-2013); Indiana Department of Local Government Finance; Indianapolis, Indiana; September 11, 2013.

Everyone’s Guide to Indiana Taxes, 2004 Edition; Freeman & Costello Press; Fort Wayne, Indiana; 2004.

Financing Local Government in Indiana; David J. Bennett and Stephanie E. Stulich; Lincoln Printing Corporation; Fort Wayne, Indiana; 1992.

“Historical and Estimated Circuit Breaker Credits”; Indiana Legislative Services Agency; Indianapolis, Indiana; December 3, 2013.

“Impact of the Property Tax Caps”; prepared by the Indiana Department of Local Government Finance; Indianapolis, Indiana; September 9, 2013.

Indiana’s Geographically Targeted Development Programs: Enterprise Zones”; Indiana Legislative Services Agency Fiscal Policy Brief; July 1, 2012.

“Local Tax Abatement”; Michael J. Hicks, PhD and Dagny G. Faulk, PhD; Ball State University Center for Business and Economic Research; Muncie, Indiana; December, 2013.

“Memorandum to the Members of the Commission on State Tax and Financing Policy Regarding the Elimination of Personal Property Assessments and Elimination of the 30% Valuation Floor for Personal Property”; prepared by the Indiana Legislative Services Agency; Indianapolis, Indiana; October 4, 2012;

“Memorandum to the Members of the General Assembly Regarding the Elimination of Personal Property Assessments and the Elimination of the 30% Valuation Floor for Personal Property”; prepared by the Indiana Legislative Services Agency; Indianapolis, Indiana; December 23, 2013.

“Memorandum to the Commission on State Tax and Financing Policy Regarding the Historical Percentage of AV Allocated to TIF”; prepared by the Legislative Services Agency; Indianapolis, Indiana; November 18, 2013.

“Memorandum to the Commission on State Tax and Financing Policy Regarding Tax Incrementing Financing by Taxing District”; prepared by the Indiana Legislative Services Agency; Indianapolis, Indiana; November 18, 2013.

“Personal Property Tax Reform in Michigan: The Fiscal and Economic Impact of SB 1065-SB 1072”; prepared by Jason Horwitz, Senior Analyst and Alex Rosaen, Consultant with the Anderson Economic Group, LLC for the Michigan Manufacturers Association; East Lansing, Michigan; April 24, 2012.

Property Tax Impact Report; Legislative Services Agency; Indianapolis, Indiana; December, 2009.

Property Tax Impact Report; Legislative Services Agency; Indianapolis, Indiana; December, 2011.

“Report on Property Tax Exemptions, Deductions, and Abatements”; Indiana Department of Local Government Finance; Indianapolis, Indiana; April 30, 2012.

“Report on Property Tax Exemptions, Deductions, and Abatements”; Indiana Department of Local Government Finance; Indianapolis, Indiana; May, 2010.

“Report on Property Tax Exemptions, Deductions, and Abatements”; Indiana Department of Local Government Finance; Indianapolis, Indiana; May, 2008.

“States Moving Away From Taxes on Tangible Personal Property” Background Paper Number 63; Joyce Errecart, Ed Gerrish, and Scott Drenkard; Tax Foundation; October, 2012.

Josep-Maria Arauzo-Carod, Daniel Livian-Solis, and Miguel Manjon-Antolin. 2010. Empirical Studies in Industrial Location: An Assessment of Their Methods and Results. *Journal of Regional Science* 50 3, pp. 685-711.

Ronald C. Fisher. 1997. The Effects of State and Local Public Services on Economic Development. *New England Economic Review* March/April, pp. 53-67.

Michael Wasylenko. 1997. Taxation and Economic Development: The State of Economic Literature. *New England Economic Review* March/April, pp. 37-52.

APPENDIX A:

What Indiana Leaders Have Said About The Reduction Or Elimination Of The Personal Property Tax

Business Organizations, Gov. Mike Pence and Republican Legislative Leaders have offered their support:

“In many categories of commercial and industrial property tax, Indiana is among the very highest states in the country. That’s largely due to our taxing of machinery and equipment. It’s a remaining black mark on our tax climate –

an area where we simply can't compete ... All of our surrounding states have done away with the tax except for Kentucky, which taxes personal property at a lower rate than Indiana. It's past time to remove this burden that can greatly hinder business expansion and innovation."

- *Indiana Chamber of Commerce President and CEO Kevin Brinegar*⁴³

"A good step toward fulfilling the governor's goal is to exempt production machinery and equipment from the personal property tax. Indiana's economy is the manufacturing-dependent in the nation, yet our state penalizes investments in production machinery and equipment by taxing those investments. It's the old adage, if you want less of something, tax it."⁴⁴

- *Indiana Manufacturers Association President Pat Kiely*

"At the end of the day, there's more work to be done. I believe the time has come to phase out the business personal property tax in the state of Indiana to spur new investment and growth. According to the Tax Foundation, Indiana has the nineteenth highest personal property taxes per capita. ... I truly do believe that by phasing out the business personal property tax in the state of Indiana we will ensure that Indiana remains at the very forefront at the competition to attract new investment and jobs—new investment by businesses that are here and new investment by businesses with which we compete. It is essential as we move into this debate that we ensure that this reform does not unduly harm our local government's abilities to meet their obligations. As Governor, my pledge in phasing this tax out is just that."

-*from Gov. Pence's remarks at the Bingham Greenebaum Doll LLP Legislative Conference*⁴⁵

"It's clear that prior tax reforms have paid off for our state. ... After capping property taxes, reducing income taxes and eliminating the death tax, Indiana has far outpaced most states in job growth. But there's still room for improvement. Senate Bill 1 will help Hoosier employers expand their operations and create jobs in our state."⁴⁶ "Small businesses are the

⁴³ "Chamber's Top 2014 Legislative Priorities"; Indiana Chamber of Commerce website; posted December 20, 2014; <http://www.indianachamberblogs.com/indiana-chambers-top-legislative-priorities-in-2014/> .

⁴⁴ "End punitive business personal property tax"; Pat Kiely, President, Indiana Manufacturers Association; letter to the editor appearing in the Indianapolis Business Journal on January 4, 2014.

⁴⁵ Governor Mike Pence's Remarks at the 2014 Bingham Greenebaum Doll LPP 2014 Legislative Conference; Indiana Convention Center; Indianapolis, Indiana; December 5, 2013; http://www.in.gov/activecalendar/EventList.aspx?fromdate=12/1/2013&todate=1/25/2014&display=Month&type=public&eventidn=149626&view=EventDetails&information_id=191709 .

⁴⁶ State Senator Brant Hershman; Senate Republican News Release; Statehouse; Indianapolis, Indiana; January 9, 2014; <http://www.indianasenatepublicans.com/news/2014/01/09/2014/president-pro-tem-long-sens.-hershman-kenley-introduce-bill-to-reduce-taxes-on-hoosier-employers/> .

backbone of any healthy economy, and the personal property tax creates a real financial burden on these employers.” ... “This bill is a fiscally responsible step toward alleviating that burden.”⁴⁷

–Senate Republicans

“Indiana must continue to be innovative and look for every opportunity to stay ahead of the competition. Providing counties an option to address the personal property tax adds another tool to their toolbox that will provide them with more flexibility in how they attract new jobs.”⁴⁸

– Speaker of the House Brian Bosma

However, not all agree that eliminating the personal property can or should be accomplished easily:

“I just think they have their priorities wrong. There’s no evidence that getting rid of this tax will bring one job to Indiana. But there will without question be a shift in the tax burden to workers, homeowners and consumers, and it will lead to more shortfalls for local governments.”⁴⁹

– House Minority Leader Scott Pelath

“Local governments would need replacement sources of tax revenue or face cutting vital public safety services and other things that residents absolutely need and expect. ... Every mayor that I have spoken with is deeply concerned about what the elimination of the personal property tax might mean to local government, to their cities.”⁵⁰

–Indiana Association of Cities and Towns Executive Director Matt Greller

David Bottorff, executive director of the Indiana Association of Counties, said other states that eliminated the business personal property tax covered the losses for local governments. He noted that Illinois’ reimbursement for local governments is included in the state’s constitution. “We’ll be seeking (for) the

⁴⁷ State Senator Luke Kenley; Senate Republican News Release; Statehouse; Indianapolis, Indiana; January 9, 2014; <http://www.indianasenaterepublicans.com/news/2014/01/09/2014/president-pro-tem-long-sens.-hershman-kenley-introduce-bill-to-reduce-taxes-on-hoosier-employers/> .

⁴⁸ Speaker of the House Brian Bosma; House Republican News Release; Indianapolis, Indiana; January 9, 2014; <http://www.insideindianabusiness.com/newsitem.asp?ID=63107> .

⁴⁹ Representative Scott Pelath; Indianapolis Star; “Mike Pence plan is all glory-no guts” by Matthew Tully; Indianapolis, Indiana; January 7, 2014; <http://www.indystar.com/story/opinion/columnists/matthew-tully/2014/01/07/tully-mike-pences-tax-plan-is-all-glory-no-guts/4355793/> .

⁵⁰ Matt Greller, Executive Director of the Indiana Association of Cities and Towns comments appearing in the Indianapolis Business Journal; December 9, 2013; <http://www.ibj.com/some-worry-about-eliminating-indiana-business-tax/PARAMS/article/45012> .

state to replace that money,” he said. Bottorff also recommended the state offer tax credits for the value of the personal property tax paid by each business, thereby footing the bill. But he said new budget estimates showing that state tax collections are expected to come in about \$298 million less than expected could hurt that request.⁵¹

⁵¹“Report: Eliminating personal property tax for business could drive up income, home rates” by Tom LoBianco, Associated Press, appearing in The Columbus Republic on December 24, 2013.

For more information, contact IFPI President John Ketzenberger at:

Indiana Fiscal Policy Institute
One American Square, Suite 150
Indianapolis, IN 46282
(317) 366-2431
www.IndianaFiscal.org