State Notes

TOPICS OF LEGISLATIVE INTEREST

Winter 2013

Personal Property Tax Reform Legislation
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On December 27, 2012, the Governor signed Public Acts (PAs) 397 through 404 of 2012, as well as PAs 406, 407, and 408. Public Acts 397 through 403 reduce property taxes levied on personal property, while PAs 404, 406, 407, and 408 provide mechanisms to potentially replace a portion of the lost tax revenue. This article will summarize these public acts, including the estimated fiscal impact on both the State and local units.

Background

Generally, personal property is property that is not affixed to a structure, such as machinery, equipment, and furniture. Personal property is classified for assessment purposes as being industrial, commercial, or utility. Statewide, personal property comprises a small share of total taxable value. In 2012, the taxable value of commercial personal property totaled approximately $9.3 billion (2.9% of total taxable value in Michigan), while industrial personal property totaled approximately $11.2 billion (3.5% of total taxable value in Michigan). Furthermore, the value of personal property remains fairly stable over time, meaning that most of the year-to-year growth in the tax base reflects growing values for real property (land and structures). One reason for this stability is that the taxable value of personal property is usually a function of the purchase price less depreciation, as determined by tables issued by the State Tax Commission, and the constitutional cap on the annual growth in taxable values. In contrast, the taxable value of real property is largely determined by current market values (again, subject to the constitutional cap on the annual growth in taxable value).

While industrial and commercial personal property represents a small portion of the tax base for most taxing jurisdictions, in some local units the total value of industrial and commercial personal property can represent a significant portion, if not a majority, of the tax base. In September 2011, the Senate Fiscal Agency (SFA) issued a report that analyzed the impact of personal property taxes on individual local units. That report is available on the SFA website at http://www.senate.michigan.gov/sfa/Publications/Issues/PersonalPropertyTaxes/PersonalPropertyTaxes.pdf.

The history of personal property taxes extends back as far as the history of general property taxes. Not only did property taxation make it easy to allocate the tax base to the "appropriate" local unit, but the tax base represented a largely visible and mostly immobile taxable item that also could easily be taxed if owned by nonresidents. The appeal of these characteristics largely reflected the difficulty of tracking income and the significantly agrarian nature of the economy that existed when most states adopted their property taxes. However, the tax on personal property is widely viewed as a tax on investment, and investment is generally regarded as essential to increasing productivity and promoting economic growth. Businesses also have become more mobile over time, and when combined with business income taxes (which are also regarded as taxes on capital and investment), various exemptions and abatements for personal property taxes have become part of the basis by which states compete for business activity. Many of the states in the Great Lakes area, as well as several major manufacturing states in the middle-Atlantic region, have eliminated their personal property taxes.

Property Tax Reductions

Public Acts 401, 402, and 403 of 2012 reduce property taxes on different types of personal property depending on several factors. Property taxes on utility personal property are not affected by the legislation. Public Acts 397 through 400 make complementary adjustments associated with PA 198 tax abatements (for industrial development in designated districts), abatements associated with technology parks, locally granted abatements, and enterprise zone abatements.

Public Act 402 exempts all commercial and industrial personal property owned by a single taxpayer and contained within a local tax collecting unit, if the total value of the industrial and commercial personal property is less than $40,000. The exemption is not based on the value of each individual piece of personal property, nor is it based on the total value of all personal property within the State. As a result, a taxpayer could have a chain of 10 stores, each with $35,000 of personal property at its location, but located in 10 different tax collecting units. Although the taxpayer's total personal property would have a taxable value of $350,000, all of the property would be exempt because within each tax collecting unit, the taxable value of the property was less than $40,000. Taxpayers must file a form each year, by February 20, in order to receive the exemption. The exemption is available beginning December 31, 2013 (for taxes that would be assessed during 2014).

Similarly, PA 401 and PA 403 eliminate personal property taxes on industrial and commercial personal property if the property meets the definition of "eligible manufacturing personal property"--which is essentially property that is used at least 50% of the time in industrial processing or direct integrated support of industrial processing. Virtually all industrial personal property is likely to meet the definition, while a portion of commercial personal property is expected to meet the definition of providing direct integrated support of industrial processing. The definition of "eligible manufacturing personal property" is not related to classifications currently used for assessment purposes, such as industrial or commercial. Instead, the definition is based on the use of the personal property. The use criteria are somewhat similar to the requirements for property that would qualify for the industrial processing exemption under the Michigan's sales and use taxes, although the legislation does not replicate or refer to that language.

Public Acts 401 and 403 will eliminate taxes on affected personal property over a period of years. Under PA 401, beginning December 31, 2015 (for taxes that would be assessed in 2016), eligible manufacturing personal property will be exempt if it was acquired after 2012. Under PA 403, eligible manufacturing personal property will be exempt, beginning December 31, 2015, if it has been subject to taxation for at least 10 years, meaning that property acquired before 2006 will be exempt. The 2006 date will advance each year after 2016, so when PA 401 and PA 403 are combined, all eligible manufacturing personal property will be exempt from property taxes by 2023. As a result, local units will initially receive less property tax revenue beginning in 2014 (due to changes under PA 402) but the loss will increase substantially in 2016 and then continue to grow through 2023 (due to PAs 401 and 403).

Local Unit Reimbursement

Public Acts 404, 406, 407, and 408 provide various mechanisms to potentially replace a portion of revenue lost as a result of PAs 397 through 403. Not all losses experienced by a taxing authority are eligible for reimbursement and the formulas to compute and/or distribute reimbursements will change over time. Furthermore, eligibility for reimbursements will change over time, both as distribution formulas are modified and as the taxable values within local units change.

Public Act 406 of 2012 allows local units, without a vote of the people, to levy, beginning January 1, 2016, a special assessment to cover all or part of the cost of acquiring and/or maintaining equipment used to provide essential services, or all or the part of the cost of providing essential services. Essential services are limited to ambulance services, fire services, police services, and jail operations. If imposed by the local unit, the assessment will be levied on parcels of real industrial and commercial property within the local unit on which exempt eligible manufacturing property is located. Losses due to the exemption of commercial and industrial property valued at less than $40,000 may not be included in calculating the assessment.

Beginning October 1, 2014, PA 404 of 2012 transfers duties currently handled by the Metropolitan Extension Telecommunications Rights-of-Way Oversight Authority to a Metropolitan Areas Metropolitan Authority (MAMA) created under PA 407 of 2012. While the MAMA will handle these duties, the primary function of the new Authority will be to levy a local use tax authorized under PA 408 and to distribute the revenue to local units. Reimbursements to local units will be determined by formulas within the Act but will not reimburse revenue lost from the $40,000 exemption or amounts that could be raised by the essential services assessment (whether or not the assessment is actually levied). Reimbursements also will not be made to local units that increase their debt mills to offset revenue losses as a result of the exemptions in PAs 401, 402, and 403. During FY 2015-16 and FY 2016-17, reimbursements will not be made to local units where the value of those exemptions lowered the taxable value in the unit by 2.3% or less, unless the unit is a community college. The MAMA also will distribute any appropriations made to the Authority during fiscal year (FY) 2013-14 or FY 2014-15 to offset revenue losses associated with mills levied to repay debts incurred prior to 2013. While the Act requires the Legislature to make these appropriations, the requirement is not considered legally binding.

The distribution formulas for reimbursements under PA 407 change over time. During FY 2013-14 and FY 2014-15, the MAMA will reimburse losses associated with debt mills only. The Act does not specify a revenue source for these reimbursements. Due to the nature of the exemptions, these reimbursements will reflect only the cost of the $40,000 exemption under PA 402. These reimbursements, which will not include reimbursements for sinking fund mills, are estimated to total approximately $12.5 million per year.

During FY 2015-16 and FY 2016-17, distributions under PA 407 will first be made to offset losses associated with school debt mills, school operating losses not reimbursed by the School Aid Fund, and losses experienced by intermediate school districts (ISDs). From any remaining revenue, distributions will be made to "qualified" local units according to each local unit's losses relative to the total loss from all qualified local units. A qualified local unit is a local unit where the value of the exemptions under PAs 401, 402, and 403 lowered the taxable value in the unit by more than 2.3%, or a community college. Thus, a qualified local unit with revenue losses that represented 3.0% of the losses of all qualified units would receive 3.0% of the revenue remaining after the distributions had been made for losses associated with school debt mills, school operating losses not reimbursed by the School Aid Fund, and losses experienced by ISDs.

In FY 2017-18, the distribution formula under PA 407 changes again. Distributions continue to be made first for losses associated with school debt mills, school operating losses not reimbursed by the School Aid Fund, and losses experienced by ISDs. After that distribution, however, a new formula requires that 5% of the remaining amount be distributed according to the taxable value of industrial real property in which personal property exempt under PAs 401, 402, and 403 is located within each local unit, relative to the total taxable value of all industrial real property in the State on which personal property exempt under PAs 401 and 403 is located. Losses associated with the $40,000 exemption under PA 402 are not included in this new distribution formula. The 5% increment increases another 5% each year after FY 2017-18, so by FY 2036-37, all of the money will be distributed under the new formula. Additionally, under the new formula, local units do not need to be "qualified" local units (experienced a 2.3% reduction in taxable value due to the exemptions) in order to receive distributions. After the distribution under the new formula, any remaining revenue is distributed according to the relative losses formula described in the previous paragraph, for distributions during FY 2015-16 and FY 2016-17.

A truncated summary of the impact of both the property tax exemptions and potential reimbursements is provided in Table 1.

Table 1

Preliminary Impact of Personal Property Tax Reform Legislation

			Calendar Year			
	2014	**2015**	**2016**	**2017**	………	**2018**
Calendar Year Revenue Losses						
State Education Tax and Local School Mills	$19.9	$20.0	$44.7	$45.0	....	$47.9
Local Government	$55.1	$55.4	$425.0	$450.9	....	$583.6
Total Calendar Year Losses	**$75.0**	**$75.4**	**$469.7**	**$495.9**	**..........**	**$631.5**
			Fiscal Year			
	2013-14	**2014-15**	**2015-16**	**2016-17**	**...........**	**2022-23**
Fiscal Year Reimbursement Distributions						
Total Fiscal Year Losses	$13.1	$32.5	$121.6	$475.3	....	$604.8
From: State Education Tax and Local School Mills	$9.9	$19.9	$32.3	$44.8	....	$47.7
State Reimbursement to Local Units (Debt mills)	$3.2	$12.6	N/A	N/A	....	N/A
Essential Services Assessment	N/A	N/A	$10.7	$68.9	....	$92.3
State Reimbursement to School Aid Fund	N/A	N/A	$32.3	$44.8	....	$47.7
State Reimbursement to Local Units (Use Tax)	N/A	N/A	$41.7	$257.5	....	$362.4
Total Reimbursements	**$3.2**	**$12.6**	**$84.7**	**$371.2**	**.........**	**$502.4**
Average Percent Reimbursed	24.6%	38.8%	69.7%	78.1%	....	83.1%

As a result of the changes in the formulas, some local units may not qualify for any distributions in FY 2015-16 or FY 2016-17, but will receive distributions in FY 2017-18. Similarly, because the calculation for determining whether a local unit is qualified will be significantly affected by the growth in taxable value for real property, it is likely that a number of local units will initially meet the criteria to be a qualified local unit but will cease to be qualified as their tax base grows. Finally, both distribution formulas (relative losses for qualified units and relative value of industrial property) allocate revenue based on the local unit's share of some statewide total, regardless of the relative magnitude of those losses to the local unit's tax base or total revenue.

Local Use Tax Ballot Issue

As required by PA 408, the August 2014 statewide ballot will include the question of whether to approve a local use tax levy by the MAMA. If approved, the State's 6.0% use tax rate will be lowered by the amount of the use tax levied by the MAMA. The rate of the use tax levied by the MAMA will be determined by the amount of revenue that the tax may generate. The revenue from the MAMA's use tax will be limited to amounts specified in the Act, which, as shown in Table 2, will total $41.7 million in FY 2015-16, increase to $257.5 million in FY 2016-17, and then rise by approximately $15.0 million to $20.0 million per year through FY 2022-23, when the total will reach $362.4 million. In fiscal years after 2022-23, the amount will increase by an industrial and personal property growth factor. Revenue from the local use tax is required to be solely, and completely, spent on reimbursements to local units eligible for distributions under PA 407. The revenue from the local use tax will reduce the State's share of use tax revenue that is directed to the General Fund. Public Act 408 also earmarks to the School Aid Fund (SAF), from the portion of the State's use tax collections that would otherwise be deposited into the General Fund, an amount equal to any lost revenue under the State Education Tax or basic school operating mills as a result of the exemptions created by PAs 401, 402, and 403, as shown in Table 2.

Table 2

Preliminary Budget Impact of Personal Property Tax Reform Legislation

	Fiscal Year					
	2013-14	**2014-15**	**2015-16**	**2016-17**	**..........**	**2022-23**
Reimbursements from General Fund						
Debt Mill Reimbursements[1)]	$3.2	$12.6	N/A	N/A	....	N/A
State Reimbursement to School Aid Fund	N/A	N/A	$32.3	$44.8	....	$47.7
Use Tax Revenue to Reimburse Local Units	N/A	N/A	$41.7	$257.5	....	$362.4
Total Reduction in General Fund Revenue	$3.2	$12.6	$74.0	$302.3	....	$410.1
SAF Losses Not Reimbursed Under Legislation[2)]	9.9	19.9	N/A	N/A	....	NA
Total Budget Impact	$13.1	$32.5	$74.0	$302.3		$410.1

1) Public Act 408 requires these reimbursements, but does not specify that they must be paid from General Fund revenue.
2) Includes both losses under the State Education Tax and local school operating mill losses.

If the ballot issue in PA 408 is approved, local units will not receive any reimbursements or replacement revenue for any revenue losses other than those associated with school debt mills, until FY 2015-16. For FY 2015-16 and later years, many local units will not receive reimbursements from the MAMA due to the conditions in PA 407, and most local units are unlikely to receive reimbursements from the MAMA that will fully replace revenue lost under the exemptions.

If the ballot issue in PA 408 is not approved, PA 407 will still require the Legislature to appropriate revenue during FY 2013-14 and FY 2014-15 to offset losses associated with debt mills. However, the property tax exemptions under PA 402 will be repealed for future years, and the other exemptions will not become effective. Similarly, none of the provisions under PAs 404, 406, 407 (except the appropriation requirement), or 408 will become effective.

Conclusion

Assuming the ballot measure passes and both the exemption provisions and reimbursement mechanisms are effective, the legislation is likely to have a significant impact on the State budget. With the exception of replacement revenue generated from the essential services assessment, all other revenue associated with reimbursing either the School Aid Fund or distributions to local units (including the local use tax revenue received by the MAMA) will reduce State General Fund revenue. As a result, General Fund revenue is expected to be reduced by approximately $3.2 million in FY 2013-14 and $12.6 million in FY 2014-15. The reduction in General Fund revenue will increase to approximately $74.0 million in FY 2015-16 and $302.3 million in FY 2016-17. By FY 2022-23, the expected reduction in General Fund revenue will exceed $410.1 million per year. Because losses to the School Aid Fund, from State Education Tax revenue and higher expenditure requirements if per-pupil funding amounts are to be maintained, are not reimbursed in FY 2013-14 and FY 2014-15, the budget impact in those years is greater than the impact on the General Fund. Legislators likely will face decisions on how to address the impact of these changes on the General Fund and School Aid Fund budgets.