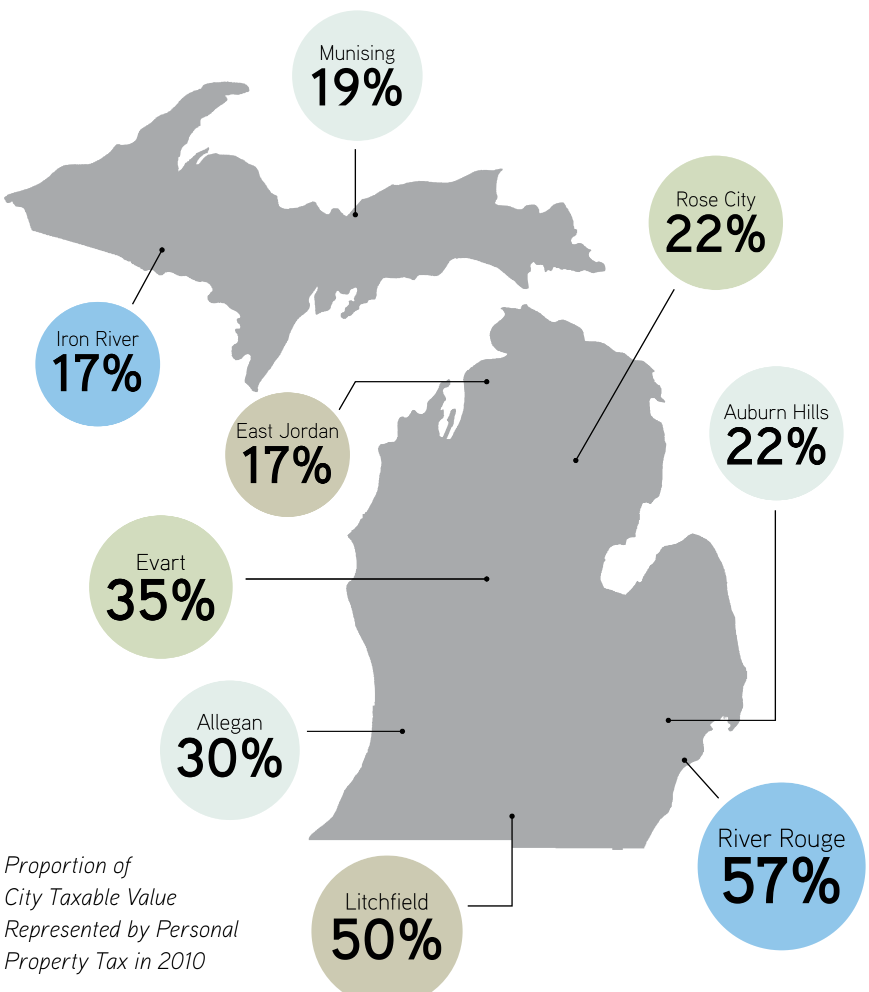
PERSONAL PROPERTY TAXES FUND
ESSENTIAL COMMUNITY SERVICES

43 OF THE 50 STATES LEVY SOME FORM OF PERSONAL PROPERTY TAX. MICHIGAN IS ONE OF THEM.

Personal property tax in Michigan is paid by businesses on property not permanently affixed to land, such as furniture, tools and computers. Michigan is one of 43 states that levy some form of personal property tax.[i] Local government revenue generated by this tax, based on voter-approved millage rates, totaled over $1 billion in 2010. Personal property accounted for, on average, over 11 percent of the taxable value in Michigan cities.[ii] In many cities, this proportion is even higher—in some cases 50 percent or more!

City Reliance on Personal Property Tax



Proportion of City Taxable Value Represented by Personal Property Tax in 2010

As national recession decimated the value of real property—land and anything affixed to it—communities became more reliant on personal property tax. Michigan cities' reliance on personal property tax significantly increased from 2008 to 2010. One reason personal property tax revenue is so crucial to communities and the services they provide is that the state places tight constraints on alternatives. For example, the 1978 Headlee amendment to the Constitution restricted local property tax increases in times of economic growth, yet provided no safety net in case of recession. The 1998 *Bolt v. City of Lansing* Supreme Court decision severely restricted the option to charge user fees for specific services and infrastructure. Local governments, with a few exceptions, are prohibited from levying sales, use, or business taxes. Local income tax, which exists in a small number of communities, is capped by the state at a low rate.

These constraints on local government revenue options, combined with the significance of personal property tax revenue to essential local services, mean that the Legislature must proceed carefully when discussing changes to the tax. See page two for an exploration of approaches several other states (Illinois, Indiana, Ohio, and Pennsylvania) took when modifying their personal property tax collections.

LOCAL GOVERNMENT REVENUE GENERATED BY THIS TAX, BASED ON VOTER-APPROVED MILLAGE RATES, TOTALED OVER $1 BILLION IN 2010.

PERSONAL PROPERTY TAX CHANGES IN OTHER STATES

Most states have some form of personal property tax, but the tax is administered in many different ways with exclusions and exceptions. In the rare state where personal property tax has been eliminated, legislators have recognized the essential value of that revenue to local services and have taken steps to replace it. To adequately support essential services in communities across Michigan, any replacement revenue must be predictable and reliable, like our current system of constitutionally-protected revenue sharing.

STATE TAX CREDIT & REIMBURSEMENT: INDIANA

One approach to reducing the personal property tax burden is to implement a state tax credit combined with a reimbursement payment to local governments. Rather than repealing the tax, some states have created a tax credit to effectively reduce payments by business owners. This mitigates the impact on local budgets while still accomplishing the goal of lowering tax on business. In cases where the credit directly reduces the amount local governments collect, states have set up special funds to reimburse municipalities for lost revenue. One example of this approach is the Indiana Property Tax Replacement Credit.[iii] This credit, created in 1973, reduces business personal property taxes by approximately 20 percent. That revenue is replaced primarily by dedicating two percent of the state sales tax to local governments. After approximately ten years of that program, the sales tax revenue was no longer sufficient, so the Indiana Legislature began appropriating additional funds from income tax revenue. When these appropriations are insufficient, the burden shifts onto business owners, who must pay higher property taxes.

ALTERNATIVE PROPERTY TAX: PITTSBURGH

A study by the University of Delaware found that traditional property tax "actually provides incentives not to maintain a piece of property."[iv] One alternative that has been associated with Pittsburgh's revitalization is to shift the property tax burden away from buildings and possessions and onto the value of the land itself. This is called "land value taxation," an approach that encourages landowners to maximize the use of their property by reducing the tax penalty for making improvements. Studies of Pittsburgh's change in approach found a strong correlation between its shift to land value taxation and its downtown revitalization and regional economic growth in the 1980s and 1990s.[v] Land value taxation encourages business investment on existing property by not increasing the assessed value when a property owner improves or constructs buildings or buys new equipment. It also helps communities deal with the problem of abandoned or blighted property.

ELIMINATION AND REPLACEMENT: ILLINOIS

In 1970, an amendment to the Illinois Constitution was adopted that directed the Legislature to abolish the tax on personal property and replace the revenue lost by local governments. Individually owned personal property, such as automobiles and household furniture, was exempted in 1970. An exemption for business property followed in 1979. To replace lost local revenue, the Legislature created the Personal Property Replacement Tax, which accompanies additional state aid payments to local governments. The replacement tax is levied against utilities and other businesses. Utilities are taxed on the basis of their invested capital, kilowatt-hours generated or gross receipts. Other businesses are subject to an income tax, at rates of 2.5% for corporations and 1.5% for partnerships, trusts and S corporations. Funds are distributed to local governments based on historic personal property tax collections.[vi]

PHASE-OUT & REPLACEMENT: OHIO

The Ohio Legislature adopted broad tax reform policy in 2005 that initiated a five-year phase-out of personal property tax for most businesses.[vii] As in Illinois, local governments' lost revenue was initially replaced by the creation of a new tax. In Ohio, this was the Commercial Activity Tax, a 0.06 percent levy on all gross receipts over $500,000.[viii] Unlike the Illinois example, however, this tax revenue was not constitutionally protected. Therefore, as Ohio faced general fund deficits, the Governor and Legislature began to eye it as an option for filling the budget hole. The fiscal year 2012-2013 budgets dramatically reduce the payments to local governments, including school districts, and change the phase-out schedule established in 2005.

Beyond these implementation challenges, it is difficult to compare Michigan's current situation to Ohio in 2005, because the two states have very different systems of local taxation. Ohio municipalities were less reliant on property taxes than those in Michigan because they had a more diverse set of revenue options available. The vast majority of Ohio cities, for example, levied income tax, and in most of those cities income tax was the primary revenue source. In some cities, income tax accounted for over 70 percent of revenue.[ix] Ohio municipalities also received the majority of revenue collected by counties through a statewide estate tax. These differences and others mean that Michigan communities, on average, rely more heavily on personal property tax. Therefore any reduction in the tax must be counterbalanced with a guaranteed, reliable replacement option.

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[i] *National Conference of State Legislatures*

[ii] *Michigan Department of Treasury. Note these numbers underestimate the importance of personal property, because they don't incorporate the industrial facilities tax.*

[iii] *For more details, see the Purdue University guide to Indiana property tax: http://www.agecon.purdue.edu/crd/localgov/topics/essays/Property_Tax_Bill.htm#PTRC*

[iv] *http://www.buec.udel.edu/craige/nta_lvt.htm#_edn9*

[v] *http://www.buec.udel.edu/craige/nta_lvt.htm#_edn9 and http://www.iris.umd.edu/Reader.aspx?TYPE=FORMAL_PUBLICATION&ID=33eb48c3-da10-46bd-aa3b-07e3933c2979&ID=33eb48c3-da10-46bd-aa3b-07e3933c2979*

[vi] *http://www.revenue.state.il.us/LocalGovernment/Overview/HowDisbursed/replacement.htm*

[vii] *http://www.mcohio.org/government/auditor/personal_property.html*

[viii] *http://tax.ohio.gov/faqs/CAT/cat.stm*

[ix] *Pagano, Michael A. and Richard Forgette. The Ohio Municipal Income Tax. Miami University Department of Political Science, November 2000.*

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