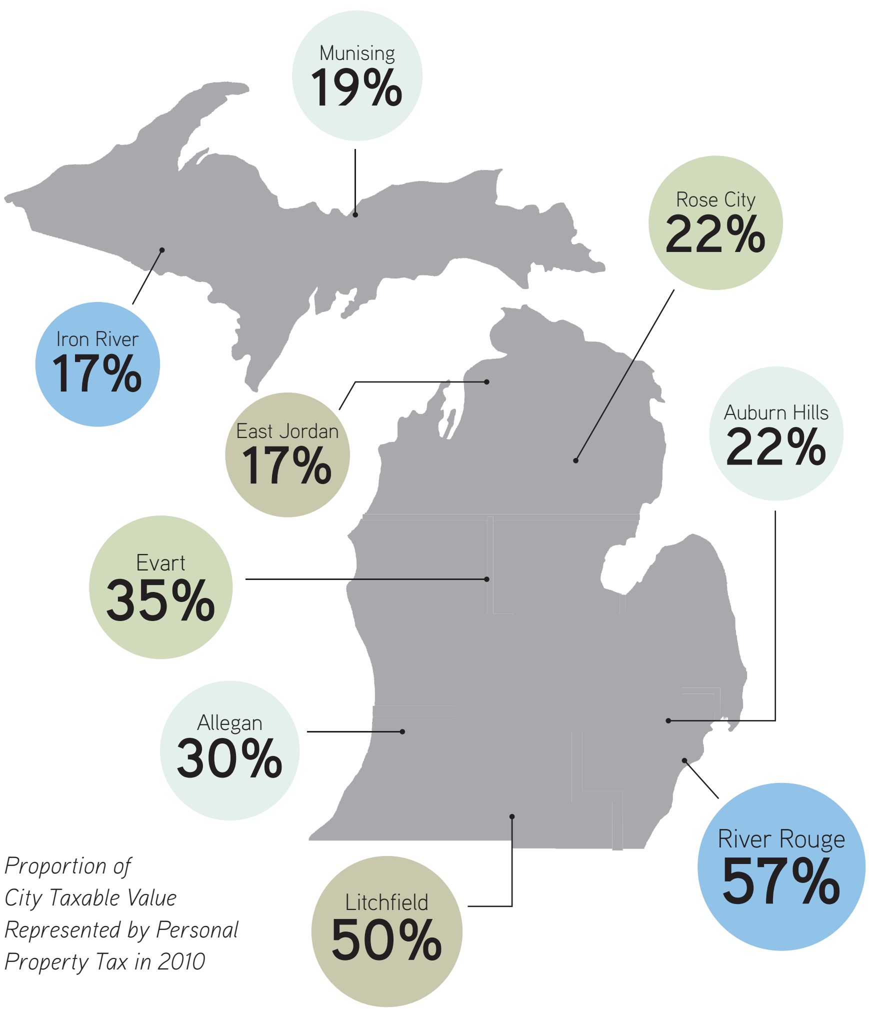
PERSONAL PROPERTY TAXES FUND
ESSENTIAL COMMUNITY SERVICES

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 revenue generated by this tax, based on voter-approved millage rates, funds a significant portion of essential community services. In 2010, personal property accounted for an average of 15.6 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

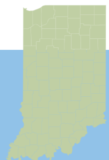
As national recession decimated the value of real property—land and anything affixed to it—communities became more reliant on personal property tax. Michigan cities' reliance on personal property tax grew by over 20 percent from 2008 to 2010. One reason personal property tax revenue is so crucial to 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. It may be helpful to examine models in other states. See page two for an exploration of creative approaches several other states (Illinois, Indiana, Iowa, and Pennsylvania) took when modifying their personal property tax collections.

MICHIGAN CITIES' RELIANCE ON PERSONAL PROPERTY TAX GREW BY OVER 20 PERCENT FROM 2008 TO 2010 AS THE VALUE OF REAL PROPERTY PLUMMETED.

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 many creative approaches to replacing 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

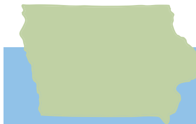
One common approach to reducing the personal property tax burden is to implement a state tax credit combined with a reimbursement payment to local governments. Rather than repealing the tax, states have created a tax credit to effectively reimburse businesses for some or all of what they paid in personal property tax. This reduces 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

One replacement option 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 rather than penalizing them for improving it. Studies of Pittsburgh's change in approach found a strong correlation between its shift to land value taxation and its impressive downtown revitalization and regional economic growth in the 1980s and 1990s.[iv] 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. A study by the University of Delaware found that traditional property tax "actually provides incentives not to maintain a piece of property."[v]

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: IOWA

Some state legislatures have chosen to gradually reduce personal property tax rates in order to soften the blow on communities. One phase-out option is to exempt property based on its age or year of acquisition. Under this approach, all items placed in service prior to a designated year are exempted and in each subsequent year, additional property becomes exempt. In Iowa this was combined with state aid payments to local governments for the first ten years of the new system. [vii]

This mechanism could be reversed to produce another option, under which newly acquired items of personal property would become exempt. For example, items placed in service after a specific date would be exempted from the tax. Over time, the taxes on personal property acquired before the exemption date will diminish as the property is retired or depreciated. At some point, the exemption could be extended to that property, as well. This option seems preferable to the Iowa system if the primary objective is to encourage new investment by business owners. [viii]

michigan municipal league

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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 and http://www.iris.umd.edu/Reader.aspx?TYPE=FORMAL_PUBLICATION&ID=33eb48c3-da10-46bd-aa3b-07e3933c2979*

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

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

[vii] *legis.wisconsin.gov/lfb/Misc/propertytaxstudy.pdf*

[viii] *ibid*