Legislative Analysis

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PHASE IN EXEMPTION FOR $10,000 OF PERSONAL PROPERTY

House Bill 4234 (Substitute H-1)
Sponsor: Rep. Glenn Steil Jr.
Committee: Tax Policy
First Analysis (3-15-04)

BRIEF SUMMARY: The bill would amend the General Property Tax Act to exempt from taxes the first $10,000 of the aggregate taxable value of personal property identified in a business's personal property tax statement. The full exemption would be phased in over a three-year period beginning in 2005. In 2005, the exempt amount would be $3,000. In 2006, the exempt amount would be $6,000. In 2007 and thereafter, the exempt amount would be $10,000.

FISCAL IMPACT: Based on information provided by the Department of Treasury, the total fiscal impact on the state and on local governments would be reduced revenue of $73 million in Fiscal Year 2005, $140 million in FY 2006, and $229 million in FY 2007.

THE APPARENT PROBLEM:

Under the General Property Tax Act, businesses in the state pay property taxes on both real property and personal property. For the purposes of administering the tax, personal property is self-reported to local assessors by each business on a personal property statement that includes a list of each item and its age. Local assessors then assign a taxable value to each item using depreciation schedules. Generally speaking, personal property is taxed in the same manner as other business property in a local unit of government. According to committee testimony, the average non-homestead (i.e. non-principal residence) property tax rate is 54 mills.

For quite sometime many in the business community and others have called for the elimination of the personal property tax. Even though the act contains a number of exemptions for various types of property and for property located in certain areas, the tax is generally viewed as being burdensome to many businesses, particularly small businesses, and a hindrance to the state's business competitiveness. Moreover, critics say the tax is sometimes an ineffective revenue source for local units because, reportedly, the actual cost of administration and collection of some tax bills exceeds the amount of personal property tax collected from taxpayers (mostly small businesses). Legislation has been introduced that would exempt a portion of the personal property of a business from taxation.

THE CONTENT OF THE BILL:

The bill would amend the General Property Tax Act to exempt $10,000 of the aggregate taxable value of the personal property as identified in the required personal property statement. The exemption would be phased in over a three-year period beginning in 2005 as follows: (1) $3,000 of the aggregate taxable value would be exempt for taxes levied in 2005, (2) $6,000 in 2006, and (3) $10,000 in 2007 and every tax year thereafter. The exemption could be claimed in each local tax collecting unit in which a required statement was submitted.

Under Section 19 of the act, a local supervisor or assessor is required to have individuals and entities they believe have personal property in their possession and who are subject to the personal property tax make and sign a written statement of all the personal property. Under the bill, a person claiming the exemption would still have to submit the required statement even if the aggregate taxable value of personal property was less than the amount of the exemption claimed.

MCL 211.9j

BACKGROUND INFORMATION:

The bill is part of the second phase of the legislative Republicans' economic development package, "Jobs Opportunities for Business Success" (JOBS II), which was unveiled in mid-February. The package is intended to spur job creation and business development in the state "by targeting tax breaks to small businesses that create jobs and eliminating many of the barriers entrepreneurs now face in starting a company and bringing their ideas to the market place." (House Republican Communications Press Release, 2-18-04) In addition to the exemption offered under this bill, the JOBS II plan includes (1) providing tax breaks to small businesses that create jobs, (2) eliminating taxation of federal and state research funds, (3) allowing the broadband authority to fund high-speed Internet infrastructure, (4) establishing a panel to recommend ways to remove burdensome business regulations, (5) keeping business bankruptcy assets in Michigan by providing an incentive for companies to participate in the bankruptcy proceeds of other in-state companies, (6) simplifying Single Business Tax forms, (7) expanding the use of private labs for state business, and (8) urging the governor to create a Michigan-Ontario Border Commission to standardize border-related rules and regulations.

ARGUMENTS:

For:

Proponents of the bill believe it is necessary for three reasons: 1) it lowers the cost of doing business in the state, 2) it sends a strong message that the state is trying to remain competitive with other states, and 3) it reduces the burden of administering the tax for local units of government,.

Critics of the personal property tax say that it sometimes a nightmare to administer and comply with, partly because it is can be difficult for a local unit to adequately assess the value (including any depreciation) of manufacturing equipment and other business equipment. The problems with administration are likely to result in taxable values that are too high or two low, which, in either case, make the tax ineffective and inefficient at best. Moreover, the personal property tax greatly cuts into the state's competitiveness with other states in attracting businesses, particularly when coupled with the single business tax. Moreover, a number of states, including Pennsylvania and Illinois, do not impose a personal property tax on businesses. While, ultimately, the personal property tax should be eliminated in its entirety, this bill in its current form recognizes the negative fiscal impact of repeal on local units of government, and instead provides for a reasonable amount of tax relief to businesses in the state, thereby encouraging business development in the state and, at the same time, protecting local finances.

There are a number of businesses throughout the state with relatively low personal property taxable values (and tax bills), and it is costly for local governments to collect taxes from these businesses. The state and local units gain very little tax revenue by collecting personal property taxes from a small business that may have, for instance, a handful of cabinets, some furniture, and office equipment, such as a computer, totaling $1,000 in taxable value. The administration and compliance costs are often more than whatever revenue may be raised by taxing these small businesses, and as such the tax becomes an inefficient and ineffective source of revenue.

The bill is also necessary to provide some tax relief to small businesses. According to committee testimony, small businesses can spend up to several hundred dollars to comply with the tax (not including the cost of the tax itself). Nothing is gained when a small business has to spend $300 to pay a $100 personal property tax bill. Exempting the first $10,000 in aggregate taxable value, even with the three-year phase-in period, lowers the cost of doing in the business in the state. This is not only good for individual businesses, but it is also good for job seekers (as the money saved will lead to increased economic activity) and the state's businesses competitiveness as well. Lowering the business tax burden is necessary to encourage resident businesses to expand in the state and out-of-state businesses to relocate to Michigan. This is particularly necessary given that the state's economic recovery has lagged behind the recovery of the rest of the country. Finally, given that the cost of doing business in the state, for reasons other than taxes, is often higher than in other states, the state should look toward lowering the business tax burden below that of competitor states.

Response:

If one of the justifications for the bill is to ease the burden placed on small businesses, the filing requirement for businesses with small personal property tax bills should also be eliminated. In some respects, the filing requirement is more burdensome than actually paying the tax, particularly for small start-up businesses. Under the bill, instead of spending $300 to pay a $100 personal property tax bill, the small business owner would spend $300 to file a personal property statement (and have no tax liability). While the bill eases the financial burden, it does not eliminate the administrative burden, which can be more costly than the actual personal property tax bill.

Against:

Opponents of the bill note that the personal property tax is primarily a local tax, not a state tax. Local governments rely heavily on property taxes, including the personal property tax. The exemption provided under the bill further erodes the ability of local units to raise sufficient revenue to meet even the most basic local government services, such a police and fire protection. Furthermore, this comes at a time when local governments have dealt with consistent cuts in revenue sharing and other state funding. Quite simply, local governments cannot afford this bill, even with the three-year phase-in. Moreover, the cuts in local services that will undoubtedly result from this bill will reduce, not improve, business competitiveness in the state. What business wants to locate in a community that cannot afford to provide adequate fire protection for the business or education for the children of its employees?

Response:

Some proponents of the bill note that this bill is a far more reasonable (and uniform) attempt at providing tax relief to businesses in the state than recent efforts to keep Electrolux and other companies that have threatened to leave the state. They argue that the City of Greenville and the state basically offered Electrolux a blank check in an attempt to keep it open and preserve the 2,700 jobs at the plant. At the time few questioned the amount in tax breaks and other incentives and where that money would come from. No one talked about how the city would continue to provide services or how much funding the school district and the state would lose if the plan went through, nor did anyone talk about the economics behind spending millions to save such a relatively few number of jobs, particularly when the state has already seen a large number of jobs leave the state. In this regard, the bill is a proactive and less costly effort to attract and retain jobs than reacting only to companies that threaten to leave. What message does it send when the state provides millions in tax incentives to companies that threaten to leave but offer little or no relief to companies that are struggling but don't see moving elsewhere as an option?

Against:

Opponents argue that the relatively small economic benefits that will result from the bill really do not justify the loss of revenue. The bill's proponents say that the tax savings will lead to greater economic activity, as this is money that can be used to expand business capacity, hire additional employees, and be spent in the community. However, when tax revenue goes to the government, it simply does not disappear into some mysterious black hole. It, too, is money that is spent on employee salaries and benefits and goods and services in this state and in the community, which also generates economic activity in the state. Employee salaries are then spent on mortgages, cars, services, durable goods, and the like. The aggregate spending by businesses as a result of the tax break isn't likely to spur economic activity beyond what would have occurred if this money went to local units of government. If a small business receives $300 ($25 per month) from this bill, is that additional tax savings really likely to encourage businesses to expand? How many new employees will by hired with an extra $25 a month? In all likelihood, the tax "savings" is unlikely to significantly increase economic activity beyond what would have occurred without the tax benefit.

On the other hand, the cumulative effect of this exemption on local governments is likely to be much more drastic and severe. Representatives of the City of Grand Rapids testified that the bill, as introduced, would reduce city revenue by several hundred thousands of dollars, in addition to similar revenue losses to the local schools and Kent County. The revenue lost from the bill could cause the city to layoff several police officers, fire fighters, or other first responders or city employees. The money "lost" by this exemption is money that will not be used to invest in roads, schools, and local services, all of which are components of the state's business competitiveness and generators of the state's economy.

Against:

The bill also presents some equity problems. As an example, suppose there are two companies of equal size, one located in Lansing, and the other with locations in Lansing, East Lansing, and Holt. Under the bill, the company with multiple locations would receive the exemption in each location; that is, it would receive three times the tax benefit of the company with one location. Is this fair?

Against:

Proponents say the bill will help small business in the state. But some opponents of the bill note that the bill is not limited to small business. While the bill does indeed apply to small business, the bill also provides the exemption to all businesses, including very large and successful ones. Critics say if the bill is truly aimed at providing tax relief to small business, it should be written that way - perhaps by excluding businesses with a taxable value of under $10,000 from the personal property tax.

Response:

Given the state's struggling economy, particularly in manufacturing, the state's tax policy encourage businesses of all shapes and sizes to move to and expand in Michigan. In addition, limiting the bill to "small" businesses by means of a personal property threshold can be problematic. Is it fair that a business with personal property of $10,000 or less pays no tax on personal property while a business with a taxable value of, for instance, $11,000 must pay taxes on the full amount? In any case, limiting the bill to only small business does very little to improve the state's overall business competitiveness.

Against:

While proponents of the bill argue that it eases the burden of administration for both local governments and small businesses, it appears to just shift that burden. Suppose there is a business with $10,500 in personal property. Under the bill, when fully phased in, the business would be taxed on $500 of personal property. Now, the cost of complying and collecting the tax from that business may not be worth the effort. But, this is precisely one of the problems the bill is apparently trying to address. The problem won't go away; it will just be shifted to other taxpayers.

POSITIONS:

The Michigan Chamber of Commerce supports the bill. (3-5-04)

The Small Business Association of Michigan supports the bill, but prefers the introduced version of the bill, and would like to see the filing requirement for small taxable values removed. (2-27-04)

The National Federation of Independent Businesses, Michigan Chapter supports the bill, but prefers the introduced version. (2-26-04)

The Michigan Retailers Association supports the bill. (2-26-04)

The Michigan Restaurant Association supports the bill. (2-26-04)

The Detroit Regional Chamber supports of the bill, but prefers the introduced version. (2-26-04)

The Department of Treasury opposes the bill. (3-5-04)

The Michigan Municipal League opposes the bill. (3-1-04)

The Michigan Townships Association opposes the bill. (3-1-04)

The Michigan Association of Counties opposes the bill. (2-26-04)

The Michigan Association of County Treasurers indicated that it is generally opposed to the bill. (2-27-04)

The Michigan Assessors Association opposes the bill. (2-24-04)

The City of Grand Rapids opposes the bill, but prefers the substitute over the introduced version, and wants the state to reimburse local units for the revenue foregone by the bill. (2-26-04)

The City of Springfield opposes the bill, but prefers the substitute over the introduced version, and wants the state to reimburse local units for the revenue foregone by the bill. (2-26-04)

The Village of Ovid opposes the bill, believing that the fiscal implications of the bill, even with the three-year phase-in, are too costly to the village and other local governments. (2-26-04)

West Bloomfield Township opposes the bill. (2-27-04)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.