The personal property tax debate—what's in, what's out

Editor's note: This article was written based on the latest information available as of Michigan Township News' *press time. Watch MTA publications for continued coverage of this evolving issue.*

After discussion swirled for more than a year, a key objective for Gov. Rick Snyder and Republican members of the state Legislature was accomplished this spring. On April 17, eight bills—Senate Bills 1065-1072—designed to eliminate property taxes on industrial personal property were introduced in the state Senate. The bills passed the Senate—with some dramatic modifications—following testimony about their impact by MTA *(see page 20)* and other local government organizations.

While the impact of this tax reform varies from township to township, from both a revenue and administrative perspective, this is indeed a critical issue to all townships. There are myriad issues involved with the proposal. This article will provide a critical analysis of the package from a local government—and particularly township—perspective.

SOME PERSONAL PROPERTY BACKGROUND

All property in Michigan is divided into two categories: real and personal. Real property is generally all land and buildings in the state. It is the assessor's duty to visit each parcel of property and place a value on the asset. Owners of real property are not required to participate in the assessment of the property, but of course, they have the right to appeal the decisions of the assessor.

Personal property, meanwhile, is generally described as machinery, office equipment, pipelines and other items that are not typically sold with the real property. Over time, certain items of personal property have been moved out of the personal property category or have been exempted by statute. At one time, for example, personal possessions of homeowners were taxed. Buildings on leased land were at one point assessed as personal, but were legislatively re-categorized as real about 15 years ago in anticipation of the eventual phase-out of personal property taxes. Personal property associated with farming is also exempt.

There are two major concerns with personal property taxes. From an economic development perspective, manufacturers have long voiced concerns over taxing their means of production. For decades, they have described the barrier to growth that the personal property tax system presents.

The second major issue—with which all townships are very familiar—is the administrative difficulties associated with personal property assessing. First of all, the system relies on self-reporting. Each year, the business owner is required to fill out a form provided by the local assessor, which describes each piece of personal property and its depreciated value. The assessor then reviews this information and modifies the values as necessary to create the state equalized values (SEV) and taxable value (TV) for the items.

From the tax collection perspective, personal property is much more difficult to collect than real property. If real property taxes are not paid, the threat of foreclosure looms. But if personal property taxes are not paid, the local treasurer must go to the court system and ask to seize property to repay back taxes—if the property is still to be found in the community. Unlike real property, where the county treasurer assumes all responsibility for collecting delinquent taxes, delinquent personal property is the responsibility of the local treasurer. (In some cases, county treasurers have offered to assume this responsibility as well.)

Another issue associated with personal property is that the tax bills are often quite small compared to real property. Small business owners often report little more than a computer and a desk, which results in very small property tax bills—which are then split between summer and winter collections. The ultimate example of administrative issues may be a typical office equipment leasing company. The leasing company is responsible for filing in every community in which they have leased equipment; each item must be identified by address to make sure that it is taxed within the right combination of governmental jurisdictions. A single company may file forms with dozens of communities for hundreds of addresses. Then, they receive individual bills twice a year for each address where they have leased equipment.

The most important date in this legislation is Dec. 31, 2015. After that date, large amounts of personal property will start coming off the tax rolls.

All personal property falls into one of three classifications: industrial, commercial or utility. In total, Michigan collects approximately $1.2 billion in personal property taxes each year. Each of the three categories generates a relatively equal amount of revenue—approximately $400 million. When the spotlight first fell on the personal property tax issue, many legislators discussed eliminating taxes on *all* personal property. However, the magnitude of the revenue loss quickly changed the focus of the debate. The proposal now focuses primarily on industrial personal property and, to a much lesser extent, commercial personal property.

In total, the proposed exemptions fall in the area of $400-$500 million per year in reduced property tax revenue. This amount would have been even greater if not for tax reforms passed in 2007, when the Legislature exempted industrial personal property from 24 mills of school taxes and commercial personal from 12 mills.

NEW TERMS

One of the most important aspects of this legislation is that while most people will speak about the fact that this proposal looks to exempt industrial personal property, the legislation actually exempts "*eligible manufacturing personal property*." This new term was created in reaction to what occurred when the Legislature created tax differentials for industrial and commercial personal property. There were some 10,000 appeals by businesses to reclassify their property in order to receive a better tax break under the new laws. Because assessing practices tied classification of the equipment to the classification of the building, there were many instances where industrial activities were taking place in buildings classified as commercial, and vice versa.

Under this legislation, the function of the personal property becomes more important than the classification. If a piece of personal property is used more than 50 percent of the time in industrial processing or in direct integrated support, it will become exempt. This means that the item must be used to change the character of the product or be part of the research and development, testing quality control, engineering or warehousing of the industrial processing. The package of bills sometimes refers to "manufacturing personal property" and, at times, uses the existing industrial or commercial classification terms. There are specific reasons and expected differences for using the three different terms *(see chart at right)*.

The proposed statute specifies that industrial processing does not include the generation of electricity for sale. This was specifically stated because currently wind turbines are classified as industrial personal property so that they are exempted from the 24 school mills. This insures that wind turbines will continue to be taxed for local government purposes.

NEW MANUFACTURING EQUIPMENT

Beginning in 2012, townships will need to track *new* manufacturing equipment. The governor is adamant that he does not want anything in this proposal to create a situation where a business might decide against making an investment today because they might get a better tax deal tomorrow. So while the proposed legislation does not exempt items until 2016, it creates special treatment for equipment that is purchased between Jan. 1, 2012, and Dec. 31, 2015. Under the legislation, any new equipment put into service during that time period will be fully taxable between 2012 and 2015.

Beginning Jan. 1, 2016, new equipment will be exempt from taxes. As has often been stated by Lt. Gov. Brian Calley, new means new. To receive this benefit, the equipment must be new and cannot be something purchased used from another company in this—or any other—state. Assessors will need to focus on this very important issue for the next few years. Once the 2016 property tax year begins, all new manufacturing personal property bought in that year (or any year thereafter) will be tax exempt.

During the interim period between 2012 and 2016, local communities can still offer tax incentives to businesses that are expanding or doing rehabilitation. Public Act 198, the Industrial Facilities Tax, may still be applied to assist a business until the general tax exemptions kick into place.

If a business brings in used manufacturing equipment, the rules change somewhat. Again, the equipment will be fully taxed between 2012 and 2015, and could be eligible for locally offered tax abatement programs. However, its taxable status in 2016 will be dependent on how long the "used" equipment had been in service in both its new and former location. Once the 2016 tax year begins, this used equipment will become exempt once it has been in service for 10 years—including the time at the new location and in its former location, even if that has been out of state. History will be a very important piece of information for the local assessor.

Type of Personal Property	Age/Value	Tax exempt, beginning in
New manufacturing	Purchased 2012-2015	2016
Existing manufacturing personal	Exempt after 10 years of age	2016
Pre-owned manufacturing	Purchased after 1/1/12, exempt after 10 years of age (both previous and current owner)	2016
Commercial industrial	Less than $40,000 taxable value	2013

EXISTING EQUIPMENT

Probably the most important date in this legislation is Dec. 31, 2015. Once that date has passed, large amounts of personal property will start coming off the tax rolls. As previously noted, all new manufacturing personal property brought onto the tax roll in 2012 or after becomes tax exempt. However, in 2016, existing personal property will begin to be exempted as well.

Beginning in 2016, and each year thereafter, any existing manufacturing personal property that has been on the tax rolls for 10 years, or used equipment under new ownership since 2012 and that has been in service for over 10 years, will become exempt from taxation. Each year between 2017 and 2022, one more group of manufacturing equipment will come off of the roll after it has been taxed, or could have been taxed if it had not been exempted, for 10 years.

The practical reality of this phase-out approach is that in 2016, the vast majority of the manufacturing tax base will become exempt. Four years of new equipment, which will have very little depreciation associated with its value, will be a significant reduction alone. Throw into the mix the very large amount of equipment that is over 10 years of age, while substantially depreciated, and that adds up to a substantial sum.

SMALL PARCELS OF INDUSTRIAL AND COMMERCIAL PERSONAL PROPERTY

Beginning Jan. 1, 2013, the legislation would exempt small parcels of personal property. Any owner of personal property who has less than $40,000 taxable value of commercial and industrial personal property combined in any one community would have that property exempted from taxation. In this particular case, the new manufacturing personal property definition is not used, and the current classifications of commercial and industrial are used. *(It is important to note that utility personal property is not included in this exemption.)*

The Snyder administration has looked at these small parcels and found that, while they represent 75 percent of the tax bills, they bring in less than 10 percent of the revenue. MTA has had a policy statement approved by the general membership for years that supports the concept of eliminating the smaller personal property tax bills.

Under the proposal, business owners would be required to assert each year that they own less than the threshold in personal property. The legislation suggests this would be a separate document from the personal property tax statement. However, it might make more sense to simply have a check box at the top of the personal property tax statement, allowing business owners to both check the box and sign the form if they have less than $40,000 in personal property, or fill out the form in the same manner as currently required if they have property that is taxable.

One of the problems of the proposal is that business owners with $40,001 in commercial and industrial personal property would owe tax on the full value of the property. This could result in individuals trying to legally segregate personal property into small batches, using multiple ownership concepts. The proposal does look at the issue of common ownership in anticipation of the use of this tax avoidance technique.

PROPERTY TAX THAT IS CURRENTLY ABATED OR EXEMPT

Many of the bills in this package of legislation make amendments to various programs that allow local governments to abate or exempt personal property taxes for a period of time. The most common example for townships is PA 198, the Industrial Facilities Tax. An industrial company looking to create, expand or rehabilitate a manufacturing facility can ask for property tax abatements or exemptions based on the type of project. Under various laws, personal property can either be taxed at a reduced rate or be exempted from taxation for a specified period of time. Various bills in this proposal would freeze existing abatements or exemptions on manufacturing personal property at the current status until the personal property becomes exempt under the new law. ▶

For example, if a community offered a 50 percent tax abatement in 2003 for 10 years, the personal property associated with that project would typically become fully taxable after the 10-year period expires in 2013. Under this proposal, the 50 percent abatement would stay in place until 2016, when the personal property would become fully exempt. This only applies to personal property that would become exempt under the new law. The real property—the building—would become fully taxable based on the timeline established by the township in 2003.

REVENUE LOST

The Senate Fiscal Agency has created a fiscal impact summary for the personal property tax plan *(see chart below)*, estimating that approximately $600 million worth of personal property would be impacted by this proposal. Of that, less than 5 percent is dedicated to township purposes. Exempting small industrial and commercial parcels is estimated to cost $80 million per year, with approximately $3.5 million of that going to townships.

The big jump in revenue loss occurs in 2016 when all manufacturing property that is at least 10 years old comes off the rolls, as well as the new manufacturing personal property purchased between 2012 and 2016. In 2016, the estimated loss of township revenue would be approximately $20 million. **After full implementation, the township loss would be just under $28 million per year.**

REPLACEMENT REVENUE

The most complicated piece of legislation in this package is SB 1072, which creates the reimbursement mechanism by which the state will distribute money to the local governments that receive property tax revenue. From the point of introduction until it was adopted by the full Senate just prior to *Michigan Township News*' press time, significant changes occurred. There is little doubt that this piece of legislation will likely change even more as it moves further through the legislative process.

The proposed statute specifies that industrial processing does not include the generation of electricity for sale. This ensures that wind turbines will continue to be taxed for local government purposes.

Generally speaking, SB 1072 is constructed to quantify how much money should be reimbursed to local governments by various categories. The legislation would fully reimburse funds that would have gone to the payment of voter-approved bonds. This was done to avoid having to raise bond millage rates to compensate for the lost revenue. The legislation also reimburses contractual obligations that exist in tax capture entities such as downtown development authorities.

Personal property tax proposal
Summary impact of Senate Bills 1065-1072 of 2012
(dollar amounts in millions)

Type of Local Unit	Calendar Year (CY) 2010 Revenue	Estimated Losses CY 2013	CY 2014	CY 2015	CY 2016	CY 2017	CY 2018	....	CY 2022
Counties	$92.9	$12.4	$12.5	$12.6	$70.3	$74.5	$79.0	....	$98.6
Cities	$153.4	$20.4	$20.6	$20.7	$116.1	$123.1	$130.5	....	$162.9
Townships	$26.0	$3.5	$3.5	$3.5	$19.7	$20.9	$22.1	....	$27.6
Villages	$7.8	$1.0	$1.0	$1.1	$5.9	$6.3	$6.6	....	$8.3
Community College	$25.8	$3.4	$3.5	$3.5	$19.5	$20.7	$22.0	....	$27.4
ISD	$52.0	$6.9	$7.0	$7.0	$39.4	$41.7	$44.2	....	$55.2
School Debt*	$70.4	$9.4	$9.4	$9.5	$53.3	$56.5	$59.9	....	$74.7
School Operating**	$37.8	$5.0	$5.1	$5.1	$28.6	$30.3	$32.2	....	$40.1
State***	$117.1	$15.6	$15.7	$15.8	$88.7	$94.0	$99.6	....	$124.3
All Other****	$16.0	$2.1	$2.1	$2.2	$12.1	$12.8	$13.6	....	$17.0
Total	**$599.2**	**$79.7**	**$80.3**	**$81.0**	**$453.6**	**$480.8**	**$509.7**	....	**$636.2**

Notes:
* Also includes sinking fund mills.
** Includes Hold-harmless mills and recreation mills. The portion attributable to regular operating mills levied on commercial personal property would require higher School Aid Fund expenditures in order to maintain per pupil funding amounts.
*** Includes Industrial Facilities Taxes (IFT) for all units, not just the State's share, as well as the State Education Tax.
**** Primarily revenue collected by authorities, such as a library or transportation authority.

Prepared by: Michigan Senate Fiscal Agency

The most important function of SB 1072 is to establish the fund to reimburse local governments for their lost tax revenues. Gov. Snyder has stated on numerous occasions that the state would not replace revenues "dollar for dollar." The formulas contained in the legislation bear this issue out. As originally introduced, the legislation would not have reimbursed local governments for an amount equal to 2 percent of their *total governmental funds*—the majority of revenue that a typical local government would receive each year. The bill was amended upon Senate passage, however, to narrow how much is to be withheld to 1 to 2 percent of *general fund* revenues. This amount still includes most of the revenue that a typical township would receive, including constitutional revenue sharing.

However, the Senate also decided that certain property tax levies should be reimbursed fully. An amendment was added to the bill during floor debate that would 100 percent reimburse any *dedicated* millage—one that specifies that it must be used for a specific purpose in the ballot language, such as a fire, police, library, road, or recreation millage. This is opposed to a general *operating* millage that can be used by the township for any purpose.

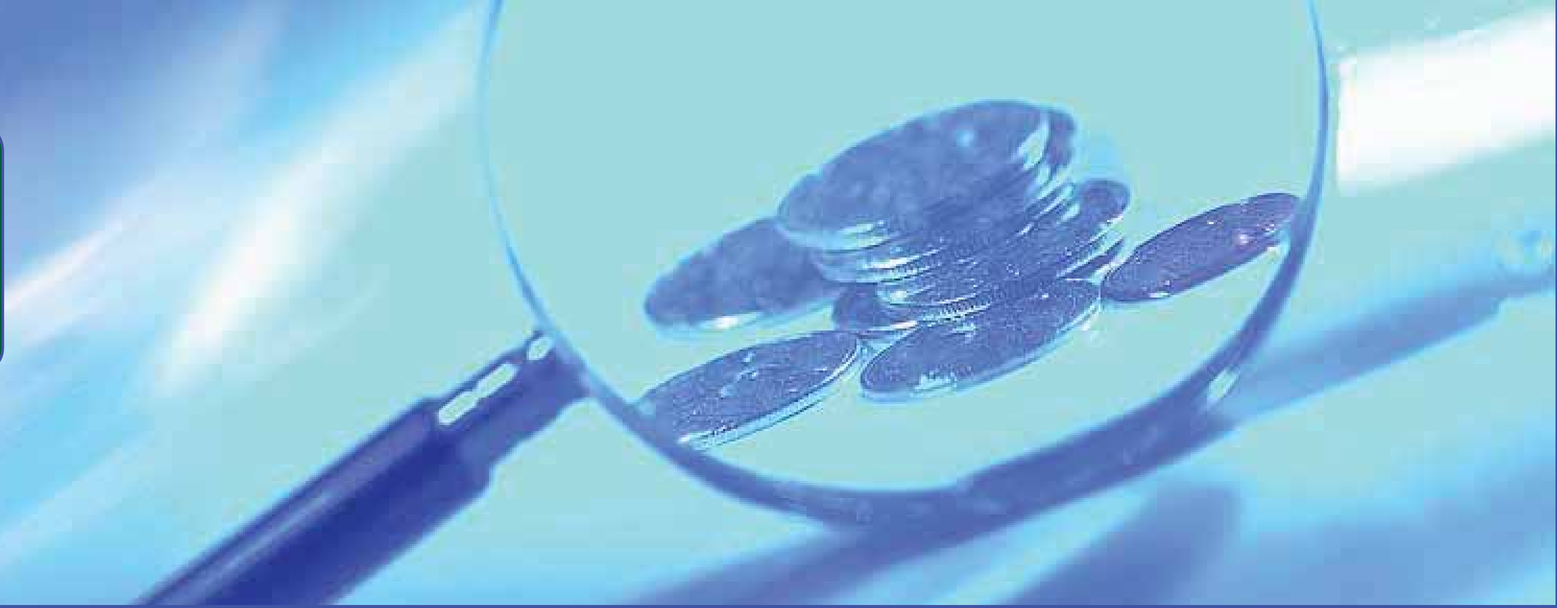
Finally, during the floor debate, the Senate also added specific provisions to several of the bills in the package, including that if the Legislature did not appropriate enough money to meet the state's refunding obligation, the tax exempt status of the personal property would be rescinded—and the property would be taxable once again. Sometimes called a "poison pill," this was a good faith showing by the Legislature that the reimbursement money would be paid.

A STATEWIDE IMPACT

SBs 1065-1072 will have an important impact across the state. While some townships will see very little financial impact, others could be dealing with a substantial portion of their property tax base. The focus of the debate has now shifted to the House. The chair of the House Tax Policy Committee, Rep. Jud Gilbert (R-Clay Twp.), has already voiced concerns over the poison pill concept. Business interests as well have begun to mobilize on this issue. There are also a number of details that need to be resolved within the legislation before it is ready for implementation. At this point in time, it is unlikely the legislation will see action in the House before summer break, and it could easily be delayed until after the November election.

Through the entire process, MTA remains focused on reducing administrative issues, making sure that communities are compensated by the state for their losses, and that this compensation will be a reliable source of revenue into the future. ■

Bill Anderson,
MTA Legislative Liaison



MTA offers compromise, starts the discussion to improve the PPT package

After SBs 1065-1072 were introduced, MTA testified before the Senate Finance Committee, proposing a compromise to prevent further chaos to local government programs and services. The logic and facts behind MTA's arguments resonated with Michigan's senators, who made broad changes to the legislation—lessening its potentially devastating impacts on local government revenues.

Townships across the state have vastly different reliance on personal property tax revenue. Some communities have little or no personal property in their community; in others, more than 50 percent of their taxes come from personal property. According to an MTA analysis, in the majority of situations where a township had an extremely high reliance on personal property, utility personal property was involved. And the most likely source of these high values? Major oil or gas pipelines that run through a community, or oil and gas wells located in the township.

In the earliest discussions of PPT elimination, it became evident that any proposal to eliminate property taxes was not going to include utility property, because it was unlikely to spur any significant additional economic development. This meant a major funding source for many townships was not going to be impacted by the legislation.

A major area of concern was one of the fastest growing sources of personal property: wind turbines. The irony of this situation was that wind turbines were not typically classified as personal property. The Legislature specified that these turbines would be industrial personal property when it decided to exempt industrial personal property from the six-mill State Education Tax and the 18 mills that school districts levy locally. MTA voiced concerns that this new source of local revenue should not be included in the plan. Again, this issue was resolved when the bills specified that only eligible "manufacturing personal property" (a new term) would be exempt, but wind turbines were specifically not included in this new definition.

THE CHALLENGES: METHOD AND AMOUNT

When the PPT bills were introduced, MTA looked at two major issues: method and amount.

While the governor had consistently stated that his proposal would not replace local revenues dollar-for-dollar, there were expectations that the plan would compensate local governments to a significant extent.

Although some local government organizations demanded a constitutional guarantee for lost revenues, MTA chose to look at the more fundamental issue. Local governments do not trust the state appropriations process. Over the past decade, Republicans and Democrats alike have failed to keep the promise established under the revenue sharing act. Cuts to payments in lieu of taxes and fire protection grants have added to the distrust. So when bills are introduced based on an assumption that some group of legislators who have yet to be elected are going to fund a program, it was not hard to understand how empty that promise seemed to local government leaders.

MTA's testimony before the Senate Finance Committee focused on the issue that a reimbursement plan based on annual state appropriations was simply unacceptable. Local governments needed additional assurances that the replacement revenue would continue to be provided without the need to fight for every dollar each year during state budget negotiations. MTA offered an alternative concept that is used in both the individual income tax system as well as Michigan's business tax system: a refundable tax credit that would actually be paid to local governments.

"This alternative goes far in satisfying the concerns of state policy leaders and local governments," MTA said in its testimony. "To address the concerns of state leadership, the Legislature could still modify or repeal the reimbursement. For local governments, a tax expenditure means a legislative change would require open debate, similar to that we are having today. And, local governments would not annually be pitted against other state budget spending concerns."

In a recent *Gongwer News Service* article, Lt. Gov. Brian Calley said, "The thing I really liked about the MTA proposal is that they don't ignore that there's economic risk for all of us in terms of what future revenue streams are; that they just want to avoid the appropriations risk." While the concept was not accepted by the administration, it did start a string of conversations about how to give greater assurances to local government that they would be reimbursed in the future.

Discussions ensued, culminating in a major modification to the personal property tax plan: to include what is commonly referred to as a "poison pill." The new language requires that if the state does not appropriate sufficient funds to reimburse local governments, the tax cuts are rescinded and businesses would once again pay personal property tax. This becomes the extra insurance that local governments will receive the funding. The alternative plan was the response to local governments and was conceived primarily by Sens. Jack Brandenburg (R-Harrison Chtr. Twp. and chairman of the Senate Finance Committee), Dave Hildenbrand (R-Lowell Chtr. Twp.) and Mike Nofs (R-Battle Creek).

The second issue MTA tackled was that of reimbursement. SB 1072 as introduced begged the question, would anyone be reimbursed? The SB 1072 formula indicated that a local government would not be reimbursed for any lost revenue that did not exceed 2 percent of its total governmental funds. Since property taxes comprise somewhere between 20 and 50 percent of the revenue of a typical township, city or county, that governmental unit could lose 4 to 10 percent of its property tax base and see no reimbursement from the state.

In its testimony, MTA told the committee, "This proposed legislation is far more draconian than what MTA anticipated. If adopted, very few local governments will ever see much, if any, of their lost industrial personal property tax revenues."

MTA further contended that—while full economic models had not been developed to project state cost for the proposal verses local costs—this formula would leave local governments absorbing the vast majority of the costs for the tax cut.

Once again, after extended discussions, the Senate responded to local government concerns, amending the legislation to reduce the maximum local government exposure to loss to 2 percent of general funds (rather than total governmental funds), as well as to fully reimburse any loss suffered to dedicated millage *(see main article for full details)*.

While the debate on cutting personal property taxes will continue, the critical issues boil down to method and amount of reimbursement. The legislation passed by the Senate will undoubtedly be modified in the House of Representatives. However, the message being presented by MTA and other local government organizations is hitting home to legislators. Reasonable surety that the state will make its future reimbursements payments is critical, and local governments—while being a partner in this tax cut plan—will not be the majority shareholder.

—Bill Anderson, MTA Legislative Liaison