

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

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FISCAL IMPACT STATEMENT

LS 6203

BILL NUMBER: SB 21

DATE PREPARED: Nov 12, 2001

BILL AMENDED:

SUBJECT: Inventory Tax Phaseout and Local Income Tax.

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FUNDS AFFECTED: **GENERAL**
 DEDICATED
 FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill phases out property taxes on inventory by establishing a deduction from assessed value of inventory that increases over a ten-year period, beginning at 10% in the first year and reaching 100% in the tenth year. It authorizes a county to accelerate the rate of the phaseout in that county or to opt out of the deduction and continue assessing property taxes on inventory in that county. The bill provides that a county that has not opted out of the inventory tax phaseout may use Economic Development Income Tax (CEDIT) revenue for increased homestead credits.

Effective Date: July 1, 2002; January 1, 2003.

Explanation of State Expenditures: As explained below in the Explanation of Local Revenues, this bill would cause a reduction in assessed value (AV). The AV reduction would cause school corporations to collect less General Fund property tax revenue from their controlled tax rate. The state's tuition support formula normally contains a mechanism whereby the state replaces any lost school General Fund revenue. If future tuition support formulas follow suit, then the state would have an increased liability under this bill.

The state currently pays 20% of school General Fund property tax levies through the state Property Tax Replacement Credit. The additional state liability under this bill would be net of the amount already paid in PTRC on the school General Fund. The net additional state liability under this bill is detailed in the table in the Explanation of Local Revenues.

Under current law, the state will allow a credit against state income tax for the property tax paid on the first \$37,500 AV of a taxpayer's business personal property in the state. This new credit is first available based on property tax paid in CY 2003 and can be claimed beginning in 2004 when taxpayers file their 2003 income tax returns. In some cases, the reduction in a taxpayer's net property tax on inventory contained in this bill could reduce the state's liability for the income tax credit. While there is no mechanism to segregate inventory from depreciable property as they apply to the \$37,500 AV credit, there are some taxpayers who

have total assessments, including inventory, at or under \$37,500. For these taxpayers it is clear that the inventory reduction in this bill would reduce the state's income tax credit liability. The amount of the reduced state liability for the income tax credit is estimated at \$3 M - \$6 M annually under this bill.

Explanation of State Revenues:

Explanation of Local Expenditures:

Explanation of Local Revenues: *Inventory Deduction:* This bill would reduce the assessed value (AV) of inventory in any county that does not opt out of the specified phaseout. An AV reduction would result in a shift of part of the property tax burden from the owners of inventory to all taxpayers in the form of an increased tax rate.

The impact on a local government's levy depends on the property tax controls of the fund. There are two basic types of property tax controls: levy controls and rate controls. If the fund is subject to levy controls, then the fund is allowed to raise a fixed dollar amount from property taxes. A drop in the assessed valuation of the fund causes the amount paid by the other taxpayers served by the unit to increase to offset the reduction. The fund experiences no loss of revenue, but the other taxpayers' liabilities would increase. Under rate controls, the property tax rate is fixed and a drop in assessed valuation results in less revenue being generated by the rate. The other taxpayers' liabilities would remain about the same. In the case of the school General Fund, the loss in revenue is made up by the state in the form of increased tuition support dollars and is not shifted to other taxpayers.

Estimation Issues: In estimating the impact of this bill, special attention was given to the impending real property reassessment. The final rules on real property assessment and personal property assessment will have a direct impact on property tax rates and the amount of the property tax levy that will be attributed to inventory. The real property reassessment will shift some of the property tax burden from personal property owners to real property owners, while the new personal property assessment rule will moderate that shift to some extent. The total increase in assessed value for 2002 pay 2003 is estimated at about 61.1% taking both the new real property and personal property rules into account. It was assumed that the next reassessment will apply to property assessed in 2002 with taxes first paid in 2003 as mandated in the latest order from the Indiana Tax Court.

Data: According to the State Tax Board's Property Tax Analysis for various years, the net property tax on inventory equaled \$407 M in CY 2000 and \$428 M in CY 2001. The 2000 pay 2001 inventory AV was \$4.70 B and has grown at an average annual rate of 3.0% over the last five years. The statewide net average property tax rate was \$8.6955 per \$100 AV in CY 2000 and \$8.8151 per \$100 AV in CY 2001.

Fiscal Impact: Future inventory assessed values were projected based on historical data. Future average net property tax rates were estimated based on historical data and on the estimated changes to the total tax base due to the newly adopted real property and personal property assessment regulations. Based on estimates of future total tax levies and total assessed values, it is estimated that the statewide average net tax rate will grow at a rate of about 1.4% per year in non-reassessment years. An estimate of the future net property tax on inventory was then computed by multiplying the estimated net assessed value of inventory by the estimated net average tax rates.

The table below illustrates the possible reduction in the net tax on inventory (and the additional state liability as explained in State Expenditures) if all counties phase out inventory over a 10-year period.

Property Tax Year	% Deduction	Net Tax Reduction on Inventory	Potential State Liability to Schools
2003	10%	\$44 M	\$11.3 M
2004	20%	\$91 M	\$22.0 M
2005	30%	\$143 M	\$34.0 M
2006	40%	\$198 M	\$46.8 M
2007	50%	\$243 M	\$60.2 M
2008	60%	\$303 M	\$74.4 M
2009	70%	\$369 M	\$89.5 M
2010	80%	\$439 M	\$105.3 M
2011	90%	\$484 M	\$122.1 M
2012	100%	\$561 M	\$139.7 M

Although this analysis assumes that reassessment will be effective for property taxes paid in 2003, further legal action could delay the effective date. For this reason, the net tax reduction on inventory was also estimated assuming that reassessment would not take place. Without reassessment, the net tax reduction on inventory under this bill could be as high as \$672 M by CY 2012.

CEDIT: This bill would also permit a county to use all or part of its County Economic Development Income Tax proceeds to pay for additional Homestead Credits in the county. While the bill does not enhance a county's taxing authority, it does allow an additional use for CEDIT revenues available under current law. Currently 60 counties have adopted CEDIT.

State Agencies Affected: State Board of Tax Commissioners (Department of Local Government Finance).

Local Agencies Affected: County fiscal bodies; County income tax councils; Local governmental units and school corporations.

Information Sources: State Board of Tax Commissioners, Property Tax Analysis, various years; Local Government Database.