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IMPACT FROM PROPOSED ELIMINATION OF PERSONAL PROPERTY TAX

Introduction
The Governor and State Legislature are engaged in discussions regarding various strategies designed to eliminate or phase out Personal Property Tax (PPT). Recognizing that PPT currently represents a significant revenue source for many local governments and school districts, the Governor announced his intention to work with organizations, associations, and local governments on finding potential sources of replacement revenue and method of distribution. Members of the Michigan Government Finance Officers Association (MGFOA) have reviewed several reports on this topic which have already been distributed by various organizations thus far. MGFOA serves to utilize the collective experience and expertise of our many members by providing technical feedback from expert practitioners in all areas of government finance. It should be noted that the MGFOA is not taking a “policy” position as to whether PPT should or should not be eliminated. Although, it should be noted that the MGFOA echoes concerns already expressed with many governmental entities being heavily dependent on PPT revenues, and that the elimination of the PPT could be the tipping point for financially stressed local units that would cause the appointment of an Emergency Manager or foster bankruptcy discussion. The purpose of this communication is to bring attention to serious issues and considerations that need to be addressed prior to the passage of legislation to eliminate PPT. This list of issues is in addition to those that have already been raised by other organizations, so it should not be considered to be a complete and comprehensive list.

Further, this communication provides some suggested considerations for replacement revenue or offsets that might help to ease the financial burden for local governments. These suggestions address some long-outstanding structural tax issues that need to be fixed. In fact, these concerns have been voiced many times over the past decade (or longer), but they have been largely ignored by former State administrations and legislatures. However, now may be an opportunity to provide some relief for local governments to partially offset the further erosion of property tax revenue which will result from the elimination of PPT. It is evident that the current Governor and legislative bodies are not afraid to make bold changes to Michigan’s tax structure. So, it is MGFOA’s hope that the current focus on PPT may be a long-awaited opportunity for a good faith effort by those in State leadership positions, in return, to fix some issues that MGFOA identifies as flaws in Michigan’s property tax structure.

The MGFOA welcomes the opportunity to meet with the appropriate State leaders to discuss the concerns of our members and to offer our expertise in an effort to avoid any negative unintended consequences that could result from the elimination of the PPT.
PPT ELIMINATION ISSUES

Debt of Tax Increment Finance Districts
There are a number of local units of government which issued bonds through downtown development authorities (DDAs) and tax increment finance authorities (TIFAs) and Local Development Finance Authorities (LDFAs). The revenue pledged to repay the debt was based on revenue captured from incremental increases in taxable values, which in some cases are largely based on industrial personal property taxes. Losing PPT as a revenue source would affect the ability for local units and tax increment districts to repay the related debt, possibly resulting in default on the debt. Depending on what the State implements to guarantee as a revenue replacement for eliminated PPT, the unique needs of tax increment authorities should be considered.

Further, the elimination of personal property will create an imbalance since personal property is included in the base value, but would no longer be included in the calculation of the incremental increase in value. In order to correct this potential inconsistent application, it seems appropriate that personal property should be treated the same, in the base value and the current value. If personal property is not to be taxed, any personal property in the base value should be eliminated retroactively and the base value should be restated moving forward. This would seem to be the minimal approach to be used for existing tax increment projects.

It may be necessary to create some kind of safe harbor for debt financed projects, as was done in 1993 when Proposal A created similar problems by reducing millage rates and reducing captured taxes. At that time, the State was responsible for reimbursing communities for the difference between the new millage rates and the prior higher millage rates. Similarly, the State may need to commit to make up the reduction in tax capture, at least for the duration of any debt issues.

Leased Property
Industrial personal property that is acquired through a leasing arrangement is classified as commercial personal property. If changes in personal property taxation are first made only to industrial property, as has been proposed, it may be that this leased property will become an issue.

Depreciation Schedules
As PPT is phased out, it should be noted that the State has negotiated accelerated depreciation schedules for certain industries (such as the automotive industry). These accelerated schedules should be analyzed, specifically as to the impact on specific communities that are dependent on automotive manufacturing, if the plan is to initially phase out industrial PPT.

CONSIDERATIONS FOR REPLACEMENT REVENUE/OFFSETS
• The classification definition of property, currently labeled ‘personal property’ needs to be reexamined. For some types of property, the classification has not always been an obvious clear conclusion – such properties are subject to interpretation and the resulting classification may have been negotiated based on the best outcome for a specialized industry. These classifications should be re-evaluated prior to removing such properties from the tax rolls, if PPT is eliminated. Consider the classification of wind turbines, for example. They are currently classified as personal property. They are income producing, and they are fixed and non-movable property. Perhaps, property such as wind turbines should be reclassified as real property. The definition of real and personal property should also be clarified in the General Property Tax Act, such as the property must be owned by the landowner to qualify as real property. If not, foreclosure of real property doesn’t work to recoup unpaid taxes.
• Perhaps to mitigate the impact of lost revenue to local governments, the depreciation schedules for personal property could be changed by extending the remaining useful life. For example, if the remaining useful life of existing equipment is 5 years, extend it to 7 years which would offset the proposed loss of revenue from exempting new equipment purchases.

• Eventually, there could be cost savings related to the reduction in personnel needs at the local units if the PPT eventually goes away. However, if PPT is phased out over a period of time, a minimal level of personnel will need to be retained until PPT is completely eliminated to canvass equipment, audit PPT returns, and collect the tax, particularly for utility and commercial personal property.

• Communities that are highly dependent on PPT would have to be held harmless if PPT is eliminated. A reasonable dependency threshold and timeline would have to be established to determine the number of communities that would be eligible for “hold harmless” funding.

• Establish incentives or disincentives to consolidate assessing at the county level. Having a county level assessment could be more equitable and consistent and reduce assessment irregularities.

• Potential replacement revenue sources – internet sales tax; eliminate or fund unfunded mandates imposed on local units; local sales tax; shift resources from expiring business tax credits to funding for local government.

• Tax increment financing has been used as one of the principal tools in order to incentivize companies to locate within Michigan. In a number of cases, communities agree to create a tax increment district, and finance necessary infrastructure improvements in order for the company to locate in Michigan. Not uncommonly the communities are asked to finance the improvements as part of a larger economic incentive package which the State, through the MEDC, creates to attract the company. The taxes generated from the facility in many cases are largely based on personal property taxes, which are then used to repay the annual debt service obligations. Should personal property taxes be eliminated, these tax increment districts and communities will not have sufficient funds to meet its debt service obligations. See also Attachment A for an example of this.
Attachment A to MGFOA
A small Village in Southeast Michigan created an LDFA and issued $10.8 million in debt in order to finance infrastructure required to incentivize a company to build an automotive engine plant in Michigan. The State MEDC was instrumental in bringing this company into the community, and was involved in the creation of the incentives offered to the company in order to locate in Michigan, including the use of Tax Increment Finance (TIF) financing to pay for the infrastructure cost. The Village issued a series of bonds totaling $10.8 million to finance the infrastructure required, with the intent and commitment the bond payments would be repaid from tax increment revenues, the majority of which was to be generated from personal property taxes. The annual debt service payment on this debt is almost $1 million annually.

The original projection in tax increment revenues to be generated was as much as $1.4 million per year assuming an 80% capture of the taxes. The company did not install as much equipment as originally committed, and also requested and received reductions in property values. This resulted in a reduction in the captured taxes available to pay debt. Even when using the full amount of the capture, there currently isn't sufficient annual tax increment revenues to cover the annual debt service obligations on all of the debt issued related to this facility.

Since personal property represents over 66% of the captured taxes, the elimination of personal property tax would create a substantial hardship for this community. Additionally, the party that benefitted by the issuance of this debt was the company, who is reaping the benefit of the use of the tax increments, largely from personal property taxes, to repay this debt.

In this case the company and the State have reaped the benefits of the original economic development project. The Village has been left with the debt burden which it assumed in order to act as a “good partner” with MEDC in attracting the company to Michigan.