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Examining the Indiana Business Personal Property Tax

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Chairperson Brown, Vice Chairperson Cherry, Members of the Committee:

My name is Scott Drenkard, and I'm an economist at the Tax Foundation. For those unfamiliar with us, we are a non-partisan, non-profit research organization that has monitored fiscal policy at all levels of government since 1937. We have produced the Facts & Figures handbook since 1941, we calculate Tax Freedom Day each year, and have a wealth of data, rankings, and other information at our website, www.TaxFoundation.org.

One of our flagship studies is the *State Business Tax Climate Index*, and last year the big story during our report release was that Indiana ousted Texas from the top ten in our ranking because of a concerted effort in recent years to lower tax rates, slow growth in government spending, and maintain competitiveness in the region. I will take this opportunity to say congratulations to this committee in particular; other states struggle to implement these thoughtful, pro-growth reforms.

I'm pleased to have the opportunity to speak today on the Indiana business personal property tax. This session represents a unique opportunity to build on the great progress Indiana has made on tax policy. While we take no position on legislation, I hope to give a review of our research on personal property taxes across the country and our understanding of the economic literature on the topic.

In 2012, the Tax Foundation released a comprehensive report on personal property taxes across the 50 states. The history of the tax is quite fascinating. While tangible personal property taxes today fall almost entirely on the personal property of businesses, historically they were applied to individuals as well. That means that taxpayers used to be required to add up their household items like coffee tables, mattresses, and china and depreciate the products according to official schedules. Auditors ostensibly were allowed to enter homes to inspect.

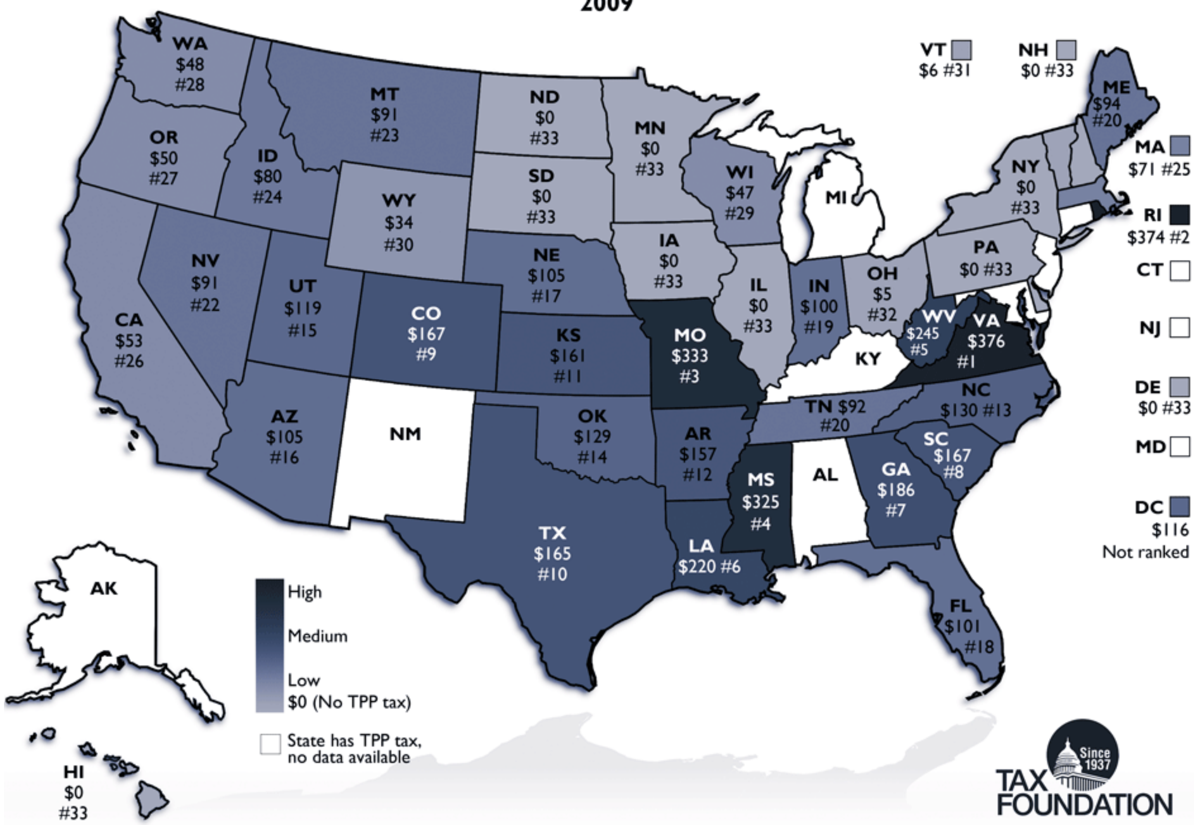
Understandably, this tax was unpopular, and taxpayers routinely hid or moved personal property during audit time. Today, household property is now almost entirely exempt across the United States with the exception of a few states that levy personal property taxes on big ticket items like cars and boats. While this is good news for taxpayers, one unintended result is that few citizens are aware that businesses still pay this tax every year on their personal property holdings.

Today, 39 states levy taxes on a broad class of tangible personal property, but reliance on the tax has decreased. On average over the period of 2000-2009, personal property tax collections per capita fell by 20 percent.

Seven states (Delaware, Hawaii, Iowa, Illinois, New York, Ohio, and Pennsylvania) have eliminated tangible personal property taxation entirely. Four additional states (Minnesota, New Jersey, North Dakota, and South Dakota) tax very little tangible personal property.

In 2012, Florida and Arizona both considered ballot measures to increase the de minimis exemption for their tangible personal property taxes, limiting the amount of property subject to the tax. These measures narrowly failed at the ballot box, but had broad, bipartisan legislative support.

Tangible Personal Property Tax Collections Per Capita
2009



Business Personal Property Taxes Distort Economic Decision-Making

I think the trend away from business personal property taxes is a promising one, because this class of tax is uniquely harmful to economic growth and productivity. While taxes on real property (land) are generally thought by tax experts to be relatively "good" taxes, taxes on personal property are more destructive. Real property taxes are roughly correlated with the benefits and protections a person or business receives from the government in that area, but taxes on personal property just disincentivize a business's decision to expand their use of technology and capital.

For example, if a bank is faced with a decision between building an ATM at a cost of $30,000 per year or hiring a bank teller at $30,500 per year, they should choose to build the ATM. But if that ATM is subject to a tangible personal property tax in excess of $500, the bank will choose to employ the bank teller instead, even though doing so is economically wasteful and that bank teller could provide more value elsewhere in the economy.

Business Personal Property Taxes are Complex

We also know that business personal property taxes have high compliance costs. Unlike taxes on real property, where assessors determine your tax bill, taxes on personal property are "taxpayer active." Businesses must file forms detailing relevant attributes of their property, including (but not limited to) a physical description, year of purchase, purchase price, and any identifying information (*e.g.*, serial numbers) that are included on the property.

While I do not know of significant empirical data on how much time businesses spend filling out personal property tax forms, we do know that the compliance burden weighs most heavily on new businesses that must find and detail this information for the first time.

Reducing Reliance on Business Personal Property Taxes

There are a number of ways that states can reduce reliance on business personal property taxes. In our study we detail a few:

Ten states have **de minimis exemptions**, which range from $500 in Texas to $225,000 in the District of Columbia. These exemptions have the advantage of limiting the amount of business personal property tax paid by small businesses. To limit compliance costs, states could additionally consider **filing thresholds**, allowing businesses with a very small amount of capital to entirely forgo the hassle of filling out these complex tax returns for what amounts to very small tax bills.

Other states like Maine and Kansas have gone the route of **exempting new property**, a way to slowly phase out business personal property taxes without a sharp drop in collections. This method has the advantage of being attractive to businesses looking to locate in the state for the first time, or businesses looking to expand their capital in the state.

In Alaska, Maryland, Vermont, and Virginia, **localities have the option to enact broad exemptions**, and this method helps to induce healthy competition for business location.

Conclusion

In closing, I'm happy to see this committee take on this issue. As I mentioned at the beginning of my remarks, business personal property taxes are largely unknown to the general public, but they distort the marketplace and have tremendous compliance costs. Indiana has in the last few years led the country on implementing pro-growth tax reform, and this represents another opportunity set an example to other states. Thank you for time today; I look forward to your questions.

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About the Tax Foundation

One of the oldest think tanks in the United States, the Tax Foundation is a non-profit, non-partisan organization that provides research and analysis on tax policy issues and the size of the tax burden at all levels of government. Based in Washington, D.C., our work advances the principles of simplicity, neutrality, transparency, and stability.

About the Center for State Fiscal Policy at the Tax Foundation

The Tax Foundation's Center for State Fiscal Policy produces timely, high-quality, and user-friendly research and analysis for policymakers and the public, shaping the state policy debate toward economically principled tax policies.