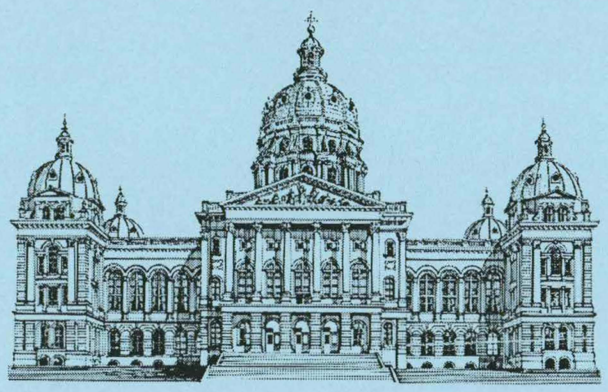
FINAL REPORT

COMMISSION ON REPLACEMENT FUNDING FOR ELIMINATION OF THE PROPERTY TAX ON INDUSTRIAL MACHINERY, EQUIPMENT, AND COMPUTERS (M & E)



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LEGISLATIVE COUNCIL
and the
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Prepared by the
LEGISLATIVE SERVICE BUREAU

Legislative Service Bureau

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Commission on Replacement Funding for Elimination of the Property Tax on Industrial Machinery, Equipment, and Computers (M & E)

February 2001

MEMBERS

Senator Larry McKibben, Cochairperson
Senator Richard Drake
Senator Gene Fraise
Senator Gene Maddox
Senator Mark Shearer
Jeannie Bettis, Monroe County Auditor
Cynthia Eisenhauer, Department of Management
Mike Flaherty, Department of Revenue and Finance
Patty Heagel, Community and Economic Development

Representative Barry Brauns, Cochairperson
Representative Clyde Bradley
Representative Polly Bukta
Representative Jack Drake
Representative Steve Richardson
Cindy Kendall, City of Marshalltown
Professor Daniel Otto, Iowa State University
Harvey Siegelman, Department of Economic Development
Bruce Slagle, City of Burlington

Contents:

Staff Contacts:

Susan Crowley, Senior Legal Counsel
(515) 281-3430
scrowle@legis.state.ia.us

Mike Goedert, Senior Legal Counsel
(515) 281-3922
mgoeder@legis.state.ia.us

AUTHORIZATION AND APPOINTMENT

In June 2000, the Legislative Council established the Commission on Replacement Funding for Elimination of the Property Tax on Industrial Machinery, Equipment, and Computers. The charge of this study was to "study the current statutory system under which reimbursement claims are calculated and funds paid by the state to local governments to replace revenue lost from the elimination of the M & E property tax, including the following: evaluating the impact of the phaseout of the M & E property tax on individual units of local government, reviewing the impact from an economic development perspective, assessing the impact of state replacement funds in mitigating the loss of local government revenue, projecting the amount of replacement funding necessary for payment of reimbursement claims to local governments through fiscal year 2006-2007, and recommend modifications of the current statutory system for calculation of reimbursement claims in order to further mitigate the revenue loss to those units of local government for which the elimination of the property tax creates a severe adverse economic impact."

I. November 17, 2000, Meeting.

Overview. The first meeting of the Commission on Replacement Funding for Elimination of the Property Tax on Industrial Machinery, Equipment, and Computers (M & E) was held on Friday, November 17, 2000. Senator McKibben and Representative Brauns were elected permanent cochairpersons. The proposed rules, which are the standard rules for interim committees, were adopted. It was clarified that the Legislative Council has established that only legislators are voting members.

A. General Property Tax Trends.

Professor David Swenson, Department of Economics, Iowa State University, discussed general property tax trends in the state. His presentation indicated trends in the components of the property tax base and changes since 1995 by metropolitan, urban, and rural counties. The trend, in relation to the entire tax base, indicates that industrial property has increased at the state average increase in the tax base and commercial property has the highest valuation growth. The M & E valuations have decreased by one-third. Professor Swenson observed that the growth in commercial valuations seems to be independent of any decrease in the M & E valuation. Professor Swenson then exhibited charts comparing growth and changes in certain classes of property by rural, urban, and metropolitan counties.

Urban counties, according to the federal Census Bureau, are those counties that contain a city with a population of at least 2,500. Metropolitan counties are those that contain a city with a population of 50,000 or more. Professor Swenson used maps of the state to display the changes in the tax base in recent years and to illustrate counties which are the beneficiaries of economic growth and counties which are not, and to illustrate any significant differences by property classification. He noted that the percent growth in residential values was equal throughout the state but that the percent growth in commercial values indicates that about two-thirds of the growth occurred in metropolitan counties. Professor Swenson stated that he did not have appropriate data to conclude that legislation to phase out the M & E property tax has driven the growth in commercial or industrial valuations. Professor Swenson finished his presentation by comparing among the counties the changes and shifts in per capita valuations from 1995 to 1999.

B. Property Valuations and State Reimbursements.

Mr. Harvey Siegelman, State Economist, Iowa Department of Economic Development, commented briefly on the report prepared by the Iowa Department of Economic Development entitled "An Analysis of the Phaseout of the Machinery, Equipment, and Computers Property Tax." The report attempted to estimate the impact of the property tax phaseout on Iowa taxing districts. Mr. Siegelman stated that 75 percent of reimbursement moneys goes to only 20 taxing districts. Mr. Siegelman observed that areas adversely impacted can be broken down into three categories. These are:

- Communities that relied heavily for their tax base on a small number of companies and that undertaxed other properties.
- Communities that relied heavily on tax increment financing districts.
- Communities with one major industry.

Ms. Alice Wisner, Fiscal Analyst, Legislative Fiscal Bureau, provided the Commission with commercial and industrial property valuations by county for the 1994 assessment year through the 1999 assessment year. Mr. Joel Gabrielson, Iowa Department of Revenue and Finance, commented briefly on the disparity between property valuations reported to the Department of Management for city and county budget purposes and the valuations reported to the Department of Revenue and Finance for purposes of computing M & E reimbursements.

C. Iowa League of Cities.

Ms. Tracy Kasson, Director of Governmental Affairs for the Iowa League of Cities, described the first five years of the state M & E replacement funding reimbursements to local governments as an attempt to maintain local government revenues based on M & E located in a taxing district in 1994. She expressed concern about the second five-year phase of state reimbursement, which would require that increases in commercial and industrial property valuations since 1994 be deducted from lost M & E valuations when computing reimbursement, for a taxing district. Rather than a gradual decline in reimbursement amounts during the second phase, there will be a dramatic drop in reimbursements to several communities, she said. Ms. Kasson stated that the League of Cities recommends that the reimbursement formula be amended to exclude commercial growth from the offset.

D. Iowa State Association of Counties.

Mr. John Easter, Director of Intergovernmental Affairs for the Iowa State Association of Counties (ISAC), stated that it has not been demonstrated with any clear measurements whether the goal behind the phaseout of the property tax on M & E is being accomplished. He stated that one effect of the phaseout has been to shift the property tax burden from targeted commercial businesses and industries to the other classes of property. He noted that M & E values make up, on average, 3.3 percent of a county's total property valuation. Twenty-five counties are above this average, with Monroe County the highest at 37.9 percent. He said that ISAC recommends the continuation of full state funding of the M & E property tax exemption until there is demonstrable evidence that the tax exemption has stimulated more growth at the local level in commercial and industrial valuation than would have occurred without the exemption.

E. General Discussion.

Mr. Mike Flaherty, Department of Revenue and Finance, stated that he could provide the latest data on valuations for the top 20 taxing districts receiving reimbursements so long as the data does not have to be obtained from county officials. Mr. Siegelman queried whether it is possible to combine the process so that only one agency does the collection of data. Mr. Ron Amosson of the Department of Management did not think combining the collection process into one agency is feasible.

II. November 30, 2000, Meeting.

The Commission held its second meeting on November 30, 2000, at the State Capitol in Des Moines.

A. System Compatibility.

Mr. Flaherty and Mr. Amosson described efforts undertaken by each department to simplify submission of M & E replacement claims data by county auditors to the Department of Revenue and Finance. Because of the information required and its purpose, both departments agree that budgetary information and replacement claim information cannot be supplied on just one reporting form.

B. State Reimbursements for M & E.

Mr. Flaherty and Mr. Gabrielson, Department of Revenue and Finance, distributed information relating to the top 10 M & E replacement claims paid shown by county and by taxing district. They also distributed a summary showing by county the replacement claims paid by the state. Ms. Cynthia Eisenhauer, Department of Management, indicated to Commission members that the state's expenditure estimate for M & E replacement claims for fiscal year 2001-2002 will be incorporated into the Governor's budget. The amount is $27.8 million. Rough projections for subsequent years are $35 million for fiscal year 2002-2003 and $36.1 million for fiscal year 2003-2004.

C. City of Muscatine.

Mr. David Casstevens, Director of Administrative Services for the City of Muscatine, described the situation the City of Muscatine was in when the phaseout of M & E began. In 1994, industrial machinery, equipment, and computers accounted for 16.3 percent of the city's tax base and had averaged over 9 percent growth for each of the preceding three years. He noted that not only is the city faced with losing a substantial portion of its property tax base but also losing the future growth of the segment of the tax base that provides the highest percentage annual growth. Mr. Casstevens stated that the city hired a consultant to assist city staff in identifying possible areas to raise additional revenue and cut costs to respond to the M & E loss. Mr. Casstevens's testimony included detailed suggestions for the Commission to consider which would alleviate the loss of revenue base caused by the phaseout of M & E.

D. City of Clinton.

Mayor LaMetta Wynn spoke on the impact the loss of the property tax on M & E has on the City of Clinton. She noted that the city's overall valuation growth has been very limited — 2.7 percent for all classes of property over the last five years. In 1994, M & E valuation comprised almost 22 percent of Clinton's total valuation. Mayor Wynn stated that the city is exploring other revenue options, including increasing property taxes to make up for the shortfall in M & E replacement funds.

E. Subcommittee Formation.

Commission members agreed that a subcommittee should be formed to consider the original goals of the phaseout of M & E, whether the replacement formula is helping to achieve those goals, and whether the original goals have changed over time. The subcommittee will also consider options for future action by the Commission. Commission members agreed that the subcommittee would be staffed by the Legislative Service Bureau with technical assistance from the Legislative Fiscal Bureau (LFB), the caucus staffs, the Department of Management (DOM), the Department of Revenue and Finance (DORF), the Iowa League of Cities, and the Iowa State Association of Counties (ISAC).

Subcommittee membership is as follows:

Representative Clyde Bradley, Chairperson
Representative Polly Bukta
Ms. Cynthia Eisenhauer, Director, Department of Management
Mr. Harvey Siegelman, State Economist, Iowa Department of Economic Development
Mr. Bruce Slagle, City Manager, City of Burlington
Ms. Cindy Kendall, Finance Director, City of Marshalltown
Professsor Dan Otto, Department of Economics, ISU
Ms. Jeannie Bettis, Monroe County Auditor
Mr. David Casstevens, Director of Administrative Services, City of Muscatine
Mr. John Moreland, Assessor, City of Clinton

III. December 14, 2000, Subcommittee Meeting.

A. Telephone Conference Call.

The Subcommittee held a telephone conference call on Thursday, December 14, 2000. The Subcommittee members gave consideration to a list prepared by staff summarizing recommendations offered to the Commission over the course of the Commission's two meetings. The Subcommittee members agreed to ask Ms. Wisner, Legislative Fiscal Bureau, to provide an analysis of the fiscal impact of four of the proposed recommendations. The four recommendations to be analyzed relate to eliminating commercial valuation from the state replacement formula, extending the phaseout time period on property taxation of M & E, computing state replacement claims on a levy authority basis rather than a taxing district basis, and allowing temporary increases in local government property tax rates for certain local governments.

IV. December 20, 2000, Subcommittee Meeting, Telephone Conference Call.

A. Tentative Recommendations.

Ms. Wisner, Legislative Fiscal Bureau, presented on her progress in analyzing the four tentative recommendations chosen by the Subcommittee during its first telephone conference call on December 14. After much discussion, the Subcommittee agreed to present three recommendations to the full Commission. The three recommendations relate to computing state replacement claims on a levy authority basis rather than a taxing district basis, allowing temporary increases in local government property tax rates, and enacting no changes to the law relating to M & E or the effect of the phaseout of state replacement funding for M & E.

The Subcommittee completed its deliberations and planned to submit the recommendations to the full Commission.

V. January 9, 2001, Meeting.

The Commission held its final meeting on January 9 at the State Capitol.

A. Subcommittee Recommendations.

Representative Bradley discussed what the Subcommittee had considered and submitted the following recommendations to the full Commission:

- Leave current law in place and allow those levy authorities most adversely affected by M & E valuation loss (as determined by meeting specific factors), to temporarily exceed their statutory property tax rate limit for the levy authorities' general fund and allow those same levy authorities to receive state replacement dollars beyond 2006 for a stated period of time.
- Change the replacement formula to compute claims based on levy authority rather than taxing district. This would provide options such as creating a special fund to enhance replacements to those communities most adversely affected by the loss of M & E valuation or would allow an extension of the replacement program.
- Do nothing. The State is halfway through the replacement program and all claims have been paid in full thus far.

Ms. Wisner briefly outlined two alternatives to determine the communities most adversely affected by machinery & equipment valuation loss, the difficulties in obtaining reliable data, and the concerns from local government officials with data that was used.

B. League of Cities Position.

Ms. Kasson handed out a position paper containing the recommendation to allow communities with a certain percentage of machinery and equipment in the tax base as of

January 1, 1994, to institute a levy to make up for the lost revenue for 10 years if approved by the local governing body.

VI. Items for Consideration by the General Assembly.

Senator McKibben presented items for consideration by the General Assembly. They were:

- Leave current law in place and allow those levy authorities most adversely affected by M & E valuation loss (as determined by meeting specific factors) to temporarily exceed their statutory property tax rate limit for the general fund if the increase has been approved by a vote of the people and allow those same levy authorities to receive state replacement dollars beyond 2006 for a stated period of time.
- Change the replacement formula to compute claims based on levy authority rather than taxing district. This would provide options such as creating a special fund to enhance replacements to those communities most adversely affected by the loss of M & E valuation, or would allow an extension of the replacement program.
- Enact a property tax limitation which removes levy rate limits and instead limits the total number of dollars available to a city or county each budget year. Such a limitation would mitigate the effects of a phaseout of the property tax on M & E by allowing cities and counties to make up for losses of revenue caused by taxable valuation loss and to allow budgets to grow by the rate of inflation regardless of valuation gain or loss.

These considerations were passed by the Commission. It was emphasized that because these are offered as items for consideration by the General Assembly and not as formal recommendations to the General Assembly, the majority vote of members from each chamber in favor was not required.

VII. Materials Received and Filed by the Legislative Service Bureau.

Materials received at the Commission meetings are on file with the LSB and are available upon request.