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Fiscal Note

Fiscal Services Division

SF 295 – Commercial Property Tax Credit (LSB 1464SV)
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Fiscal Note Version – New

Description

Senate File 295 creates a new property tax credit for property classified as commercial, industrial, or railroad property (C/I/Rail). The new tax credit will be financed through an annual appropriation from the State General Fund. The appropriation will pay a portion of the property taxes due each year on property classified as C/I/Rail.

The tax credit will be equal to the difference between the taxes owed on the C/I/Rail property, and the taxes owed on a residential property of the same value and located in the same taxing district, up to a maximum property value called the Credit Base.

Prior to each fiscal year, the Department of Revenue will calculate the Credit Base utilizing a complete list of credit-eligible properties along with their taxed value and tax rate. The task of the Department will be to determine the maximum Credit Base that will allow expenditure of 98.0% of the funds available that year. All properties with taxed value at or below the Credit Base for the year will be taxed like residential property, while properties with value in excess of the Credit Base will have the value up to the Credit Base taxed like residential and the value above the Credit Base taxed as commercial, industrial, and railroad property is currently taxed.

The Bill provides for an FY 2015 appropriation of $50.0 million from the State General Fund to finance the credit. That appropriation is increased $50.0 million every year that net General Fund receipt growth exceeds 4.0%. For the FY 2016 appropriation to equal $100.0 million, FY 2014 General Fund growth must exceed 4.0%. The appropriation maximum is $250.0 million. If General Fund growth does not achieve the 4.0% target, the appropriation remains at the previous year's level. The Revenue Estimating Conference is responsible for certifying the annual General Fund increase percentage for the recently completed fiscal year.

Background

For the property classifications of residential, commercial, industrial, and railroad, the assessed value of a property is the property's market value as determined by the assessor (railroad property is centrally assessed by the Iowa Department of Revenue, the remaining classifications are assessed by local assessors). The assessed value of agricultural property is determined through a net earnings and capitalization process.

Iowa property tax law provides for limits on the annual percent of increase in statewide taxable value a class of property may experience, due to revaluation of existing property, in a tax year. To adjust statewide assessed values to the proper taxable value for each property class, a system of assessed value rollbacks is in place. The rollback is the percent of a property's assessed value that is subject to taxation that tax year. A rollback of 50.0% means that a property is taxed at 50.0% of its assessed value, while a rollback of 100.0% means that a property is taxed at 100.0% of its assessed value. The rollback percent for a property class applies equally to every taxed property within a class.

Since implementation more than 30 years ago, residential property has developed a substantial and persistent rollback, while agriculture property has developed significant rollbacks on two occasions. Commercial property has never developed more than a small rollback in even-numbered years, while industrial property has not experienced any rollback since assessment year (AY) 1983.

The rollback experience of these property classes is the result in very large part to the different patterns of property value inflation that has occurred over the past 30 years. Existing residential property has tended to rise in market value, while the value of commercial property tends to increase more slowly and industrial property has revalued very little through the years. Due to its foundation as a net income calculation, agricultural property value tends to increase significantly in times of commodity inflation and then decrease in value as commodity prices reverse.

Over the past 12 fiscal years, net General Fund revenue increased more than 4.0% in eight years and less than that percentage in four years. The four years that revenue did not increase at least 4.0% were FY 2002, FY 2003, FY 2009, and FY 2010. Each of the four years followed the start of a U.S. economic recession.

Assumptions and Estimate Process

The Legislative Services Agency utilized property-specific taxed value and tax rate information covering 95.0% of the value of commercial and industrial property in Iowa as the basis for the Credit Base projection. The estimate process was adjusted to compensate for the missing 5.0% of property value. A spreadsheet model was developed that projected the General Fund dollars that will be expended at various levels of Credit Base for each of the fiscal years, given the assumed taxed value and tax rate for each property. The Credit Base was then optimized at a projected level that expended 98.0% of the funds available in that fiscal year for financing the new tax credit.

- The State has approximately 123,000 individual commercial and industrial properties with taxable value for AY 2012.
- For each assessment year, the value of every property subject to tax in AY 2012 is increased by the same assumed statewide revaluation percentage.
- The AY 2012 tax rate for each property is assumed to be the average tax rate for FY 2013 for all commercial and industrial property within the applicable assessment area. The property tax rate for each property is assumed to increase 0.5% each fiscal year.
- In developing estimates of the Credit Base for each year, several projection issues were not addressed in the model. To some extent, the four issues will counterbalance.
    - Railroad property was not included in the model. The tax credit system is designed to allow each rail line to receive one property tax credit for each county the rail line passes through. A rail line that passes through 10 counties will receive 10 separate credits.
    - No adjustment is made for any increase or decrease in the number of commercial and industrial properties after AY 2012.
    - While the database used was based on individual properties, the tax credit is based on a property “unit” concept, where properties owned by the same people or entities and utilized for the same purpose will have their property value combined when calculating the credit.
    - All property owners must apply for the credit once and the application is sufficient for future years until a change of ownership occurs. No adjustment is made for property owners not filing claims for the credit.

- The following table presents the assumed annual growth rates discussed in bullets two and three above, as well as the assumed residential and C/I/Rail rollbacks each year. The table also includes the projected Credit Base for each tax year.

Key Assumptions and Projected Credit Base

	Residential Rollback	C/I/Rail Rollback	Rollback Difference	Projected Credit Base	Revaluation Growth Rate	Growth in Average Tax Rate
FY 2014	52.8%	100.0%	47.2%	N/A	-0.17%	0.50%
FY 2015	53.7%	100.0%	46.3%	$ 29,000	0.75%	0.50%
FY 2016	55.8%	100.0%	44.2%	72,000	0.25%	0.50%
FY 2017	55.8%	100.0%	44.2%	129,000	2.00%	0.50%
FY 2018	57.8%	100.0%	42.2%	224,000	0.25%	0.50%
FY 2019	57.2%	100.0%	42.8%	323,000	3.50%	0.50%

Fiscal Impact

Senate File 295 will require a State General Fund appropriation each year to finance the new C/I/Rail property tax credit. Assuming State General Fund net receipts increase by 4.0% or more for FY 2014 through FY 2017, the State General Fund appropriations required by this Bill will equal:

- FY 2015 = $50.0 million
- FY 2016 = $100.0 million
- FY 2017 = $150.0 million
- FY 2018 = $200.0 million
- FY 2019 and after = $250.0 million

Should State General Fund revenue not increase by 4.0% in any of the years between and including FY 2014 through FY 2017, the increase to $250.0 million will be delayed.

Since the property tax reduction is in the form of a credit and not an exemption or other process that reduces the value subject to tax, the General Fund appropriation for State School Aid and property tax rates are not impacted.

There will be State and local administrative costs for implementing the new tax credit. The Department of Revenue will be responsible for calculating the Credit Base each year, with the first calculation needed in June 2014. The responsibilities of county officials will include accepting and approving credit applications, as well as submitting valid applications, property unit taxed values, and property tax rates to the Department of Revenue, and also applying the proper tax credit to property tax statements. The Department estimates their administrative costs at $12,300 for FY 2014 and $6,000 annually thereafter.

Sources

County and city assessor commercial and industrial property value records
Department of Management historical property tax records
Legislative Services Agency property tax projections

/s/ Holly M. Lyons

March 13, 2013

The fiscal note for this bill was prepared pursuant to **Joint Rule 17** and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.