Legislative Service Bureau

FINAL REPORT

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
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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."

- 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 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.

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.