

No. 764

April 2, 1965

THE TANGIBLE PERSONAL PROPERTY TAX ON MACHINERY AND EQUIPMENT IN MICHIGAN

The taxation of tangible personal property (machinery, equipment, business inventories, furniture, etc.) in Michigan has been a frequent subject of controversy in recent years and current discussions of new depreciation schedules for machinery and equipment indicate the subject is still a lively one. Discussions of the problem of taxing tangible personal property under the ad valorem property tax have revolved around two basic and inter-related issues:

1. How to achieve the "uniform general ad valorem taxation of real and tangible personal property" required by the constitution and laws of the state; and,
2. How to make the tax burden on industry in Michigan competitive with tax burdens in those states with which Michigan is competing for job creating industries.

The background of these two issues will clarify the present controversy.

The Uniform Rule of Taxation

The Michigan Constitution provides:

The legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law. The legislature shall provide for the determination of true cash value of such property; the proportion of true cash value at which such property shall be uniformly assessed, which shall not, after January 1, 1966, exceed 50 percent; and for a system of equalization of assessments¹

¹ Article IX, Section 3, of the Constitution of 1963. The previous constitution provided, "The legislature shall provide by law a uniform rule of taxation"

It is generally recognized that there has been a lack of uniformity between assessments on tangible personal property and on real property, despite the constitutional requirements and a number of statutory provisions, including appeal procedures and equalization of assessments, designed to provide for uniform and equitable assessments of real and tangible personal property.

In 1957, the Dodge Committee on City Finance, appointed by the Mayor of Detroit, reviewed assessment practices in the City and found the following:

. . . it is plainly apparent that in a city such as Detroit, where the average assessment ratio on residential real estate is about 45 per cent and the average on commercial and industrial real estate is close to 60 per cent, a policy of assessing personal property of business at ratios which vary from 90 per cent of current cost in the case of inventories to 100 per cent of cost as depreciated by the assessor in the case of machinery and equipment, must produce an obvious inequality

The Citizens Advisory Committee of the Michigan Tax Study made the following recommendation to the legislature in 1959:

It is recommended that all tangible and intangible personalty other than tangible inventories be exempt from ad valorem taxation.

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Despite its value to local units of government as a producer of substantial revenue, the property tax on machinery, equipment, tools, fixtures and so forth is opposed on grounds of equity. In addition to the fact that equitable assessments are unattainable, the impact of the tax bears little or no relation to the volume or profitability of business.

In 1961, the Citizens Income Tax Study Committee in the City of Detroit reported to the Common Council its findings:

Both real and personal property are valued at varying fractions of their "true cash value," a practice that is inconsistent with the uniformity requirement of the Constitution. The inequities are especially prominent in the assessment of personalty.

The 1962 Census of Government report on Taxable Property Values shows that by 1961 in the City of Detroit non-farm houses were assessed on the average at 42-46 per cent of their sales price. Under the schedules used in 1961, the City of Detroit assessed new machinery and equipment at 75 per cent of its original cost.

These and other studies of assessment practices found widespread lack of uniformity in assessments, particularly in the practice of assessing tangible personal property at a higher level than real property. Recognizing this lack of unifor-

mity, the state tax commission worked in a cooperative effort with local assessors to achieve a more uniform standard of assessment of personal property. While the tax commission had only limited power to set assessment standards, it did have the power to review individual assessments on appeal and to make recommendations on state equalized values. Through this cooperative approach, for example, in the City of Detroit substantial progress was made by bringing down the assessment percentage on new machinery and equipment from 90 per cent of original cost in 1960, to 54 per cent of original cost in 1965 by successive annual decreases. Similar cooperative efforts were also underway in out-state areas. In spite of these efforts, there continued to be a significant lack of uniformity in the assessment of tangible personal property within and among the 1,800 assessing jurisdictions in the state.

Various schedules were being used by the different assessing jurisdictions in Michigan to determine the true cash value of machinery and equipment. And, once true cash value had been established, the several assessing jurisdictions were applying different assessment ratios (e.g., 100%, 50%, 30%, etc.) to arrive at the assessed value of the property. Often this ratio was different from that applied to real property.

The problem therefore was two-fold – 1) to establish a method that would provide for a uniform determination of the true cash value of machinery and equipment in Michigan’s 1,800 assessing jurisdictions; and, 2) to establish the proportion of true cash value at which such property was to be assessed.

Act 122 of 1962 provided a method for achieving uniformity in the determination of true cash values. The act required that local assessing officials use only manuals (written schedules and procedures) prepared or approved by the state tax commission as a guide in making assessments.² Thus, Act 122 provided an answer to one part of the problem – a basis for the uniform determination of true cash value of machinery and equipment in Michigan’s 1,800 assessing jurisdictions.

The second portion of the problem – determination of the proportion of true cash value at which property is to be assessed – remains to be solved. The constitution provides that the legislature shall establish the proportion of true cash value at which such property shall be uniformly assessed, which shall not, after January 1, 1966, exceed 50 per cent.

² The constitution requires the legislature to provide for the determination of “true cash value” and the legislature as defined “cash value” as the price which could be obtained for the property at a private sale between a willing buyer and a willing seller – in effect, “cash value” is market value. While this type of definition of cash value is commonly used, it creates a problem because it is virtually impossible to determine the price at private sale of the tremendous number of highly specialized items of machinery and equipment used by Michigan business and industry. It is, therefore, necessary to use some type of schedule for the mass appraisal of machinery and equipment.

Comparative Tax Burdens on Industry in Michigan and Other States

The second issue with respect to the taxation of tangible personal property has been to make Michigan's tax burden on industry competitive with other states. In the late 1950s, Michigan became concerned about the relative tax burdens on industry in Michigan and in its competitor states in terms of Michigan's ability to compete for new job-producing industries. A number of independent research studies were conducted of the relative tax burden on industry in Michigan and in other states. In June, 1960, the Research Council released a memorandum summarizing the results of three of these studies conducted by the University of Wisconsin, the Pennsylvania Economy League, Inc., and the Michigan Senate Tax Study Committee.³

That memorandum stated the findings of these three studies as showing:

The Research Council has reviewed the available materials relating to industrial tax burdens in Michigan and other states and the overwhelming weight of the evidence is that Michigan imposes a heavier tax burden on industry than its principal competitor states.

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All three of these studies also show clearly that local taxes and particularly the personal property tax are primarily responsible for Michigan's heavy tax burden on manufacturing industry compared to other states.

These three studies show that local taxes paid by industry in Michigan average about two-thirds of the total state and local tax burden. The three studies show that the tangible personal property tax constitutes on the average some 60-68 per cent of the local tax burden. And, all three studies show that the tangible personal property tax is on the average about 40 per cent of the total state and local tax burden on industry in Michigan.

All three studies show that compared to other states Michigan imposes a heavy tax burden on industrial personal property. New York and Pennsylvania do not tax tangible personal property at all, and the three studies show that in Illinois, Ohio, New Jersey, and Wisconsin the tax burden on tangible personal property ranges from 30 percent to 77 percent of the burden in Michigan. Of the seven competitor states, only Indiana approaches Michigan in the taxation of tangible personal property.

These studies, together with all other available evidence, indicated that Michigan imposed a heavier state-local tax burden on industry than its competitor

³ Citizens Research Council, Taxes on Industry in Michigan, June, 1960. See also Citizens Research Council Backgrounds of Michigan State and Local Financial Problems—A Pictorial Handbook, Report No. 202, October, 1960.

states and that the tangible personal property tax was the major factor in the tax burden on industry in Michigan.

Changes Proposed in the Taxation of Tangible Personal Property

To solve the problems created by Michigan's relatively heavy taxation of tangible personal property, a number of changes were proposed by various groups:

The 1958 Michigan Tax Study Citizens Advisory Committee recommended that all tangible personal property, except inventories, be exempt from the general property tax, which would have reduced this tax burden by about \$120 million.

In 1961, Governor Swainson recommended to the legislature that tangible personal property be exempt from the general property tax and that a specific tax be imposed on machinery and equipment at a rate of \$9 per \$1,000 of original cost. The proposed rates of the specific tax were, on the average, about one half of the effective ad valorem property tax rate and this would have resulted in a decrease in the tax burden on tangible personal property of about \$120 million.

In 1962, Governor Swainson recommended that machinery and equipment used in certain manufacturing operations be exempt from the general property tax and estimated that this would relieve the tangible personal property tax burden by \$65 million a year.

None of these proposals for exempting all or a portion of tangible personal property from the general property tax was adopted.

With the failure of these solutions, the emphasis shifted to means of achieving uniformity in the assessment of tangible personal property and a competitive tax structure within the ad valorem property tax structure.

New Depreciation Schedules for Machinery and Equipment

Following the enactment of Act 122 of the Public Acts of 1962 which gave the tax commission authority to propose or approve assessing manuals and schedules, the state tax commission began a series of studies to establish appropriate methods of determining the true cash value of industrial machinery and equipment. The Research Council was requested by the then chairman of the state tax commission to provide research assistance in this area.

One of the studies undertaken by the Research Council compared the method of computing true cash value in Michigan with that used in other states. Data were obtained for Michigan, Indiana, New Jersey and Ohio as to the true cash value of \$1.0 million (original cost) of machinery and equipment acquired over a period of years. New York and Pennsylvania do not tax tangible personal prop-

erty and comparable data were not available for Illinois and Wisconsin. The study compared the 1962 and proposed 1963 schedules used by the field staff of the Michigan state tax commission for determining true cash value for equalization purposes with the 1962 schedules used by the other states in calculating true cash value of industrial machinery and equipment. The study showed that the true cash value of machinery and equipment with an original cost of \$1,0 million in each of the states would have been as follows:

	<u>True Cash Value</u>
Michigan - 1962 Schedule	\$715,000
- 1963 Schedule	667,000
Indiana	480,000
New Jersey	370,000
Ohio	501,000

The true cash value of such property in Indiana would have been 61 per cent of the 1963 Michigan schedule, while New Jersey and Ohio would have been 55 per cent and 75 per cent, respectively. This survey confirmed the findings of the other studies.

The state tax commission in the fall of 1964 issued new depreciation schedules for machinery and equipment to be used by local assessors in 1965 and thereafter. When the new schedule is applied to the same \$1.0 million original cost of machinery and equipment cited previously, the following comparison emerges:

	<u>Full Value</u>
Michigan - 1965 (New Schedule)	\$472,000
Indiana	480,000
New Jersey	370,000
Ohio	501,000

Conclusion

The new state tax commission schedule places Michigan in a competitive position with these other states – true cash value in Michigan will still be significantly higher than in New Jersey, but slightly lower than in Indiana and Ohio. The actual property taxes paid will depend upon the proportion of true cash value at which the property is assessed and upon the tax rate applied to the property. Michigan's new schedule, coupled with the recent exemption of tools, dies, and jigs from ad valorem taxation, will make Michigan relatively more attractive to industry and the use of state schedules will provide a basis for more uniform assessment of tangible personal property throughout the state.