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PROPOSED CHANGES IN MICHIGAN'S PERSONAL PROPERTY TAX TABLES

In Brief

The Michigan Department of Treasury has released proposed changes in the factors used to compute the assessed value of personal property based on its acquisition value and age.

The changes expand the number of categories of personal property from seven to eleven and base the depreciation on a statistical study performed by BDO Seidman, LLP.

The changes for most categories will result in faster depreciation, resulting in a 10 to 15 percent reduction in personal property taxes. The impact of this reduction will be approximately $130 million on local units and $117 million on the state.

In May 1999, the Michigan Department of Treasury released draft revisions in the way personal property is valued for tax purposes. The State Tax Commission, located in Treasury, is expected to make a final determination relative to the proposed changes in August.

About 13 percent of the total taxable value of property in Michigan is in personal property. The rest of taxable value is in real property. Real property is basically land and buildings. Personal property is all other property not specifically exempted from taxation. It generally is movable and not permanently affixed to the land.[1] It includes a broad array of assets including most equipment, furniture, and fixtures used by businesses.

The determination of personal property assessments, upon which the ultimate tax levy is based, has been the subject of criticism and controversy for many years. Generally, a taxable piece of personal property is entered on the assessment rolls at one-half of the initial cost (its equalized value). This initial assessment is then subjected each year to a calculation that reduces its value by a composite factor contained in one of seven schedules designed to reflect the asset's declining value as it is used. The composite factors are a combination of a trending factor intended to reflect the replacement cost of the asset and a factor that reflects the remaining value after deduction for depreciation.

Depreciation is the loss in value from physical, functional and external causes. *Physical* depreciation is wear and tear, damage, and breakage. *Functional* obsolescence is caused by changes in similar assets in the market rendering the subject asset relatively inadequate and costly to operate. *External* obsolescence reflects loss in value due to factors such as laws and regulations limiting use of the asset.[2]

The schedules currently used to calculate the decline in value are very general and usually bear little relationship to the specific kind of asset being assessed.

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[1] State law requires that certain types of real property be assessed as personal property such as electric poles and lines, gas pipelines, buildings on leased land, and improvements made by the leaseholder.

[2] This description of the composite factors is consistent with material contained in the BDO Seidman study supporting the proposed changes in the personal property tax tables.

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Moreover, the tables have not been comprehensively analyzed and revised in more than thirty years.

Not surprisingly, the strongest critics of the personal property tables are taxpayers who argue that their tax bills are unfairly high as a result of tables that depreciate assets too slowly. If approved as proposed, an overall reduction of 10 to 15 percent in property taxes on personal property is predicted by the Department of Treasury.

Current Practice

Personal property is depreciated using tables for one of the following seven categories:

(1) Gas Distribution
(2) Electric Transmission & Distribution and Oil Pipelines
(3) Gas Transmission
(4) Long-lived Assets
(5) Average-lived Assets
(6) Short-lived Assets
(7) Computers

Criticisms of the current tables fall into at least three areas:

- Decline in value is too slow—that is, assets are generally overvalued (and therefore overtaxed), especially in the early years of use.
- The tables do not make enough distinction between different types of assets and the result is that certain assets are overtaxed because they are "thrown in" with other dissimilar assets.
- The current tables stop depreciating assets too soon, causing assets whose value should still be declining to level out at amounts that are too high.

The Proposed Remedy

In a study commissioned by the State, BDO Seidman, an accounting, tax and consulting firm, employed statistical methods to estimate the depreciation experienced by 11 groups of asset types:

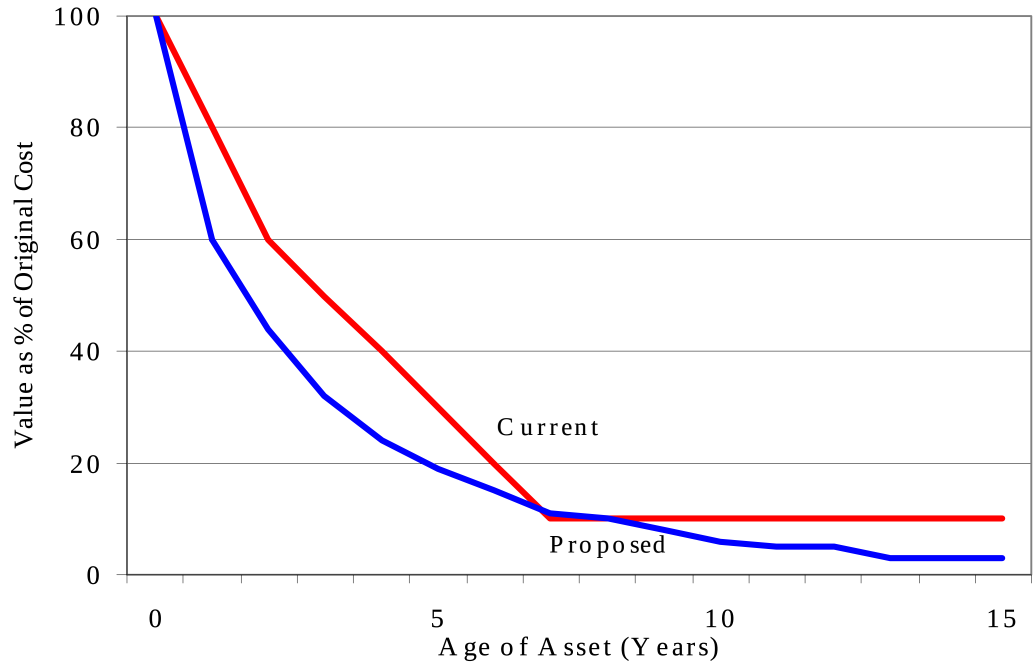
(1) Cable Equipment
(2) Computer & Peripheral Equipment
(3) Improvements
(4) Machinery & Equipment
(5) Computer-Controlled Machinery & Equipment
(6) Furniture & Fixtures
(7) Office Machines
(8) Electronics, Video & Test Equipment
(9) Restaurant Equipment
(10) Consumer-Coin Operated Equipment
(11) Consumer-Utilized Equipment

The proposed multipliers result in lower taxable values for about half of the categories during the early years of an asset's use when compared with the current multipliers. In the outyears, all categories except Improvements reflect lower taxable values with the proposed multipliers.

An example used frequently to illustrate the issue is computer equipment. The technology is changing so rapidly that it is often stated, only half jokingly, that computers are obsolete before they are installed. The current multipliers imply that a three-year old computer has 50 percent of its original value and 30 percent of its value at five years. The proposed multipliers would reduce those value percentages to 32 percent and 19 percent respectively, in each case by more than a third. **Chart 1** depicts the overall effects on computer equipment multiplier percentages over a 15-year period.

The resulting percentage reductions in assessments for computer equipment are larger than for most other categories. Some categories of assets have proposed multipliers that would cause increases in assessments and taxes. **Charts 2-5** provide illustrations of some common asset types and the current and proposed multipliers. The comparisons are made with three current multiplier schedules that are generally based on the expected useful life of the assets for the category illustrated.

Chart 1
Computers & Peripheral Equipment



- Short life — rapid obsolescence and advances in technical improvement; multiplier constant at 30 percent beginning in seventh year of age

- Average life — adaptable to product change or technical advances, ease of relocation; multiplier constant at 30 percent beginning in fifteenth year of age

- Long life — longevity due to relatively stable technology, occurrence in basic heavy manufacturing, durability characterized by steady output; multiplier constant at 40 percent beginning in fifteenth year of age.

Fiscal Impact

The Department of Treasury estimates that taxes on personal property will be reduced 10 to 15 percent if the proposed tables are implemented. The financial impact falls roughly evenly between the State and local units. Treasury estimates the revenue and budget impact to the State at $117 million, roughly half state revenue and half increased state school aid expenditure requirements resulting from lost local revenues. Other local unit revenue losses are gauged at $130 million. However, personal property as a percent of the tax base varies significantly between local units and the fiscal impact on individual units will vary as a consequence. A companion CRC Notes on the distribution of personal property between local units will provide an analysis of this issue.

Prospects for Implementation

The prospect of tax reductions is appealing to the business community, but local government officials will be faced with potential losses in property tax revenue averaging one to two percent statewide. However, the problems identified with the current practice are serious and the proposed remedy appears soundly based in empirical analysis. It seems likely that the proposed changes will not encounter any compelling resistance and new tables, perhaps revised during the review process, will be used to establish assessments effective December 31, 1999.

Chart 2
Office Equipment

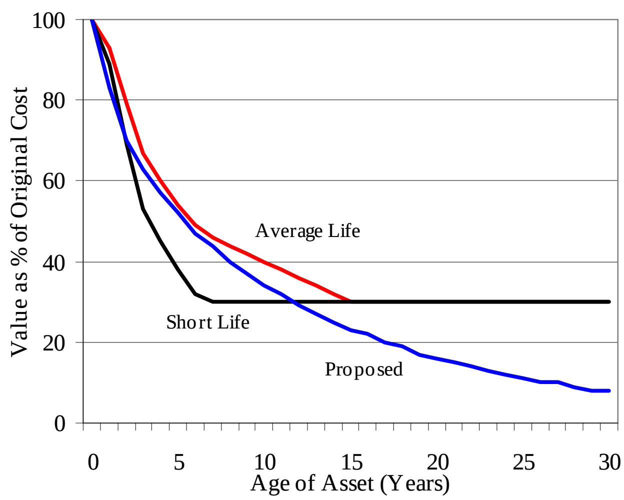


Chart 3
Leasehold Improvements

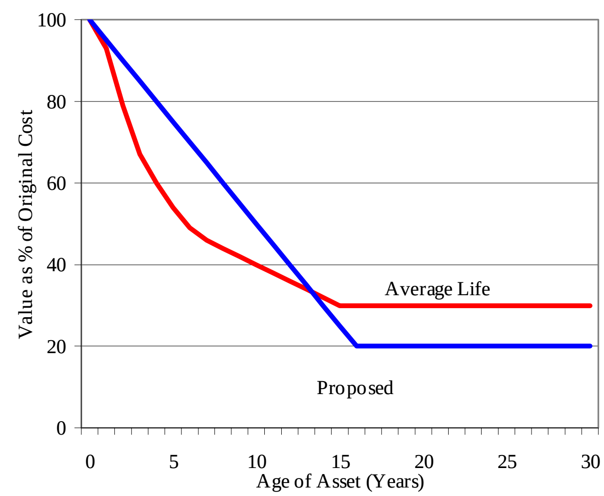


Chart 4
Machinery & Equipment

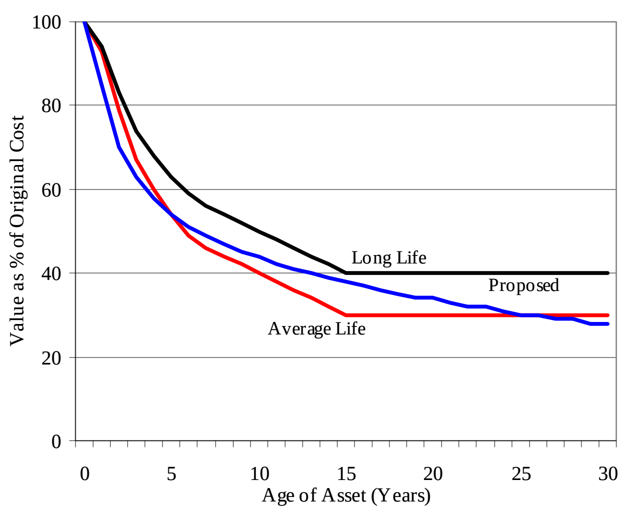


Chart 5
Furniture and Fixtures