POLICY BRIEF

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Unfair and Unbalanced

Plan shifts commercial property tax to residential property taxpayers

In the rush to close the legislative session, proposals with potentially far-reaching impacts are not receiving the scrutiny they deserve. One such proposal, House File 691 — provisions of which were incorporated by the House into Senate File 522 — would reduce commercial property tax assessments by 40 percent over five years. This is an unnecessary cut in our already low-tax state. Reducing commercial property taxes would further shift local funding of cities, schools and counties to residential property taxpayers. In addition to reducing commercial property taxes, the bill severely limits the ability of local governments to meet the needs of their citizens.

Any proposals to cut taxes should be automatically suspect when Iowa faces funding challenges and no balance is offered to assure adequate and stable revenues to meet public priorities. This is doubly the case with proposals as poorly conceived and poorly analyzed in a public forum as this legislation. Backroom deals on policy of this magnitude are destined to produce poor results.

Iowa's Business Taxes Already Low

When one considers the whole range of state and local taxes that fall on businesses, Iowa is a low-tax state. In a report on overall taxes, including property taxes, paid by businesses, the nationally recognized accounting firm of Ernst and Young recently showed that only 15 states taxed businesses at a lower rate than Iowa as a percent of private-sector GDP.[1]

Commercial Property Tax Break Will Spur Little or No Growth

A state or local government's tax rate — be it corporate income or commercial property or the combination of all taxes on business — is a tiny portion of a business' overall costs. Taken together, state and local taxes on business are, on average, only about 1.8 percent of total business costs.[2] The commercial property tax by itself would be an even tinier fraction of a business' overall costs. Furthermore, cities already routinely use Iowa's Tax Increment Financing law to provide generous rebates of property taxes on new commercial and industrial buildings. The notion that cutting commercial property taxes further by reducing assessments will bring in new economic activity and new revenue is a pipe dream.

Bill Would Shift Taxes from Business to Residential

The bill mandates a 40 percent reduction in commercial and industrial property assessments, phased in over five years. At the same time, the annual growth in taxable residential and agricultural property value allowable under the rollback formula would be reduced from 4 percent to 2 percent. The net effect is still a sizable shift in taxes from commercial and industrial to residential property. Under current law, estimates by the Legislative Services agency indicate that the residential share of taxable property (and hence of taxes paid) will increase from 47 percent in FY2013 to 50 percent in FY2018, while the commercial share declines a little, from 29 percent to 26 percent, and agricultural property stays at 19 percent. But the House-passed version of SF522 would substantially magnify the shift from commercial to residential: The commercial share would drop all the way to 20 percent while the residential share rises to 54 percent.[3]

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The bill does express a "legislative intent" to partially reimburse localities for the loss in revenue due to the new assessment limitations on commercial property. But there is no guarantee that even the partial reimbursement will continue. If past practice is a guide, it will not.

Limitations on Local Governments

In addition to slashing business property taxes, the legislation limits the amount of property tax revenue city and county governments may raise to support public services, in exchange for eliminating the cap on property tax rates (the "general fund levy limit"). Revenue growth from one year to the next would be limited to inflation plus new property valuation.

This limitation is problematic for a number of reasons. First, inflation will be measured by the consumer price index (CPI). The CPI tracks the prices of a market basket of goods and services purchased by households. However, the CPI tends to underestimate inflation for costs affecting government. State and local government budgets are largely driven by personnel costs, and the cost to of hiring workers has steadily increased as insurance costs have increased at a pace faster than inflation. Between 2000 and 2010, the consumer price index increased by over 26 percent; the state and local governments price index increased by more than 44 percent over the same period.[4] Over time the revenue limitation would force substantial cuts in local government services because revenues would not be allowed to increase as fast as costs, a problem aggravated by the bill's limitation on the inflation factor to four percent regardless of actual inflation. Since 2000, the state and local government price index increased by more than 4 percent from year to year six times.[5]

The formula may force further service cutbacks and employee layoffs through another provision. Most local services are services to people, and it is population growth that necessitates expansion of services and increases in local budgets. The formula does not allow for revenue to grow along with population, but instead allows it to grow only with construction of new taxable property. This provision puts additional pressure on local governments to engage in unfair "fiscal zoning" practices to exclude properties that tend to bring in families with children and with below-average valuation, and encourage only high-value property that brings with it few people and few additional demands on services. The alternative is to cut services because revenues can't keep up with the needs of a growing population.

For schools, the promise to replace a share of property tax funding with state aid will be far more costly to the state than projected, in the wake of daunting state cutbacks and stated resolve of some leaders to further reduce state spending. The fiscal note for the bill projects an additional state cost escalating to almost $550 million when fully phased in, in 2019, but even this estimate is heavily understated. The estimate assumes zero percent growth in per-pupil spending authority for FY2012 through FY2019 — even though Iowa lawmakers have never held allowable growth that low for even one year. The prospect of future state budget cuts in lean years when a greater share of budget authority comes from state aid will introduce a new measure of fiscal instability for local districts, which already have seen their share of instability due to state actions. Clearly, this part of the proposal needs greater study.

A bill this complex and far-reaching demands further analysis and discussion than the General Assembly has given it. Likewise, Iowans should demand far more study than this legislation has received. Legislators are elected for two- and four-year terms and a year remains before the next election; there is no need for a rush to judgment.

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[1] Ernst and Young for the Council on State Taxation. Total State and local business taxes: State-by-state estimates for fiscal year 2009. March 1, 2010. <http://www.cost/org/StateTaxLibrary.aspx?id=17768>, as cited in "Iowa's Businesses Already are Taxed Lightly," Iowa Fiscal Partnership, February 9, 2011. <http://www.iowafiscal.org/2011docs/110209-IFP-biztaxes-bgd.pdf>.

[2] Peter S. Fisher, "Corporate Taxes and State Economic Growth," Iowa Fiscal Partnership, February 2011. <http://www.iowafiscal.org/2011docs/110209-IFP-corptaxes.pdf>.

[3] Iowa Fiscal Partnership calculations from data provided by the Legislative Services Agency, Fiscal Services Division, relating to the impact of HF691 on taxable valuations.

[4] Iowa Fiscal Partnership calculations of Consumer Price Index for all Urban Consumers (CPI-U) and National Income and Product Accounts (NIPA) price index for state and local government.

[5] Iowa Fiscal Partnership calculations of NIPA price index for state and local government.