LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 7518 **DATE PREPARED:** Apr 7, 2001
BILL NUMBER: HB 1480 **BILL AMENDED:** Apr 5, 2001

SUBJECT: Various State and Local Taxes.

FISCAL ANALYST: Diane Powers, Bob Sigalow
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FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) This bill makes various changes concerning the Gross Income Tax, the Sales and Use Tax, the Adjusted Gross Income Tax, federal tax refunds for Indiana income taxes owed, ordinances regarding local taxes, and Roth IRAs and educational IRAs.

The bill provides that oil inspection fees collected by licensed gasoline distributors are not gross income.

It removes vehicle identification information from the income tax return.

The bill also provides that the state welfare allocations calculated as part of the financial institutions tax distributions and the motor vehicle excise tax distributions are based on amounts levied by counties for the county welfare fund and the county welfare administration fund, rather than the amounts appropriated from those funds.

The Investment Income Tax Credit is repealed.

The bill also corrects internal references.

This bill allows South Bend, and Fort Wayne to establish economic development project districts. The bill provides that the districts must contain a commercial retail facility with at least 500,000 square feet. It allows sales tax increment financing to be used in each district for road, interchange, and right of way improvements and for real property acquisitions to further these purposes. The bill also allows Evansville to establish an economic development project district and it authorizes the redevelopment commission in Evansville to distribute money from the sales tax increment financing fund for certain purposes. This bill allows sales tax increment financing in the Fort Wayne district to also be used for the demolition of commercial property and any related expenses incurred before or after the demolition. It provides that not more than 50% of the net increment each year may be used for these purposes and it provides that not more than a total of $1,000,000

of sales tax revenue increment may be captured during the existence of the district.

The bill allows a property tax abatement to a property owner in a town located in a county with a population of more than 50,000 but less than 60,000 if the town approved the abatement but the owner is ineligible because of a failure of the owner to comply with statutory requirements. It provides that the abatement is allowed if the owner and the town comply with all statutory requirements before July 1, 2001.

This bill changes the maximum Knox County innkeeper's tax rate from 3% to 5%.

The bill phases out the inventory tax (subject to the authority of the county council or county income tax council to opt out of or accelerate the phase out).

It allows use of EDIT revenue for increased homestead credits and allows an increase of the EDIT rate up to .25% over the current maximum rate to provide increased homestead credits.

This bill enacts the simplified Sales and Use Tax Administration Act. It provides for the appointment of four delegates to enter into multistate discussions concerning the Simplified Sales and Use Tax Agreement. The bill permits the Department of State Revenue to enter into the agreement with other states to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance for all sellers and for all types of commerce. It specifies certain requirements that must be included in the agreement before the state of Indiana may enter into the agreement. It also includes certain provisions concerning certified service providers (an agent certified jointly by the states to perform all of a seller's sales tax functions). The bill specifies that no provision of the agreement invalidates or amends any provision of Indiana law.

The bill legalizes an order of the State Board of Tax Commissioners approving an adjustment of the base assessed value for an allocation area in Hammond.

Effective Date: (Amended) January 1, 1999 (retroactive); Upon passage; January 1, 2001 (retroactive); July 1, 2001; January 1, 2002.

Explanation of State Expenditures: (Revised) *Vehicle identification information:* This bill deletes the requirement that the Department of State Revenue (DOR) obtain vehicle identification information from taxpayers on the tax return.

Sales Tax Remittance & Reports: The requirement that remitters of sales and use tax pay monthly, but only file reports on a quarterly basis is designed to create administrative savings for the Department and taxpayers.

Sales and Use Tax Administration Act: This bill will have a minor administrative impact on the Department of State Revenue. The administrative costs and staff time required by this bill are expected to be absorbed using the Department’s existing staff and resources.

The bill provides for the appointment of four delegates to enter into multistate discussions concerning the Simplified Sales and Use Tax Agreement. The delegation will include: one member of the House of Representatives, one member of the Senate, an appointee of the Governor, and the Commissioner of the Department of Revenue. Expenses incurred by the legislative members of the delegation would be paid by the Legislative Services Agency. Expenses incurred by the delegate who is not a state employee would be provided by the Department of Commerce or the Civil Rights Commission. Travel costs for the

Commissioner of the Department of Revenue would be paid through funds appropriated to the Department.

Inventory Deduction: As explained below in Local Revenues, this provision would cause a reduction in assessed value (AV). The AV reduction would cause school corporations to collect less General Fund property tax revenue from their controlled tax rate. The state's tuition support formula normally contains a mechanism whereby the state replaces any lost school General Fund revenue. If future tuition support formulas follow suit, then the state would have an increased liability under this bill.

The state already pays 20% of school General Fund property tax levies through the state Property Tax Replacement Credit. The additional state liability under this bill would be net of the amount already paid by in PTRC on the school General Fund. The net additional state school funding liability under this provision is detailed in the table in Local Revenues.

Also, as explained below in Local Revenues, this provision would shift some property taxes to homesteaders. Since the State pays Homestead Credits against a homesteader's property tax liability, the State's Homestead Credit expense would increase. The potential shift to homeowners is estimated at about $160 M if all counties accept the inventory phaseout. The potential increase in Homestead Credits (paid at 4%) is estimated at $6.4 M. Homestead Credits are paid from the Property Tax Replacement Fund which is annually supplemented by the state General Fund. Any additional Homestead Credit expenditures would ultimately come from the General Fund.

Explanation of State Revenues: (Revised) *County Remittance*: This bill allows county treasurers to remit gross income tax receipts from the sale or transfer of an interest in real estate to the Department of State Revenue on the 20th day of the month following the end of a quarterly period. Current law requires the remittance to be on the 15th day of the month. This will result in a minimal loss of interest earnings from the five-day delay of receiving these tax receipts, but it will bring the remittance dates in conformity with other tax filing dates.

Sales Tax Remittance: This bill would require all retailers with an average monthly tax liability over $25 to remit the sales tax on a monthly basis. The frequency with which a retailer must submit sales tax collections to the Department of State Revenue is based on the retailer's average monthly sales tax liability for the previous calendar year. Although the impact of this bill on the state's sales tax revenue over the FY 2002-FY 2003 biennium is expected to be minimal, the shift from quarterly filing to monthly filing will cause a portion of the sales tax revenue that would have been remitted in FY 2003 to instead be remitted in FY 2002. Based on CY 1999 data, it is estimated that the bill will shift approximately **$ 4 M** of expected FY 2003 sales tax revenue to FY 2002. As a point of information, approximately 59,000 filers (19% of the total number of filers) remit sales tax collections to the DOR on a quarterly basis.

Sales and Use Tax Administration Act: This bill will not impact current sales tax revenue collections. The bill specifies that adoption of an agreement by Indiana does not amend or modify any Indiana law.

Background: The Streamlined Sales Tax Project is an attempt to address the growing problem of collecting sales and use taxes on goods purchased via the Internet, catalogs, and other remote sellers. As of September 11, 2000, 27 states have formally joined the Streamlined Sales Tax Project through legislative enactments or executive orders. The project seeks to remove the burden of collecting sales taxes from remote sellers through a simplification of state sales and use tax structures, which would be applied in a more uniform way. Participation in the project would be voluntary for both remote sellers and states. The system would use certified technology providers to calculate, collect, and, should the seller choose, remit the proper sales or use tax directly to the state.

In theory, removing the burdens of collecting sales taxes from remote sellers would help the state collect sales taxes that currently go uncollected. Studies have estimated a wide range in the amount of revenue that Indiana may forgo because of uncaptured taxes on remote sales. Estimates from the United States General Accounting Office range from $134 M to $ 444 M, while other researchers have estimated the loss from Internet sales alone at approximately $174 M.

Gross Retail (Sales) and Use taxes are deposited in the State General Fund (59.03%), the Property Tax Replacement Fund (40%), the Public Mass Transportation Fund (0.76%), the Commuter Rail Service Fund (0.17%), and the Industrial Rail Service Loan Fund (0.04%).

Use Tax exemption: The bill clarifies that the use tax exemption for tangible personal property processed in Indiana by commercial printers and transported out of Indiana for sole use outside of Indiana applies to property that is delivered into Indiana from sources within or outside the state. Any impact would be negligible.

Definition of dependent: For purposes of the employee medical care savings account plans, the definition of dependent is changed to be consistent with the Internal Revenue Code. This change expands the definition, except for the exclusion of mentally or physically incapacitated children over the age of 18.

Oil Inspection Fees: The bill provides that oil inspection fees collected by licensed gasoline distributors are not considered gross income for purposes of calculating a taxpayer's tax liability. According to the Department of State Revenue, this exemption would result in a $60,000 reduction in Gross Income Tax revenue. This revenue is deposited in the General Fund.

Repealed Tax Credit: This bill also repeals the Investment Income Tax Credit. According to the Department of State Revenue, no one has utilized this credit, so there will be no impact resulting from its repeal.

ERA: The State levies a tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds.

Economic Development Project Districts: The establishment of economic development project districts in South Bend, Ft. Wayne, and Evansville could reduce state sales tax revenue by a total of $3 M. This bill allows these cities to establish a district and use up to 50% of the net increment of sales tax revenue generated in the district each year. The overall impact of this provision on state revenue will be determined by local actions. It is not known how much sales tax will be collected and transferred annually.

This bill does not give the cities' redevelopment commissions the privilege to collect a sales tax. It does, however, allow the commissions to capture a portion of the increase in sales tax revenue collected in the district that is *above* the revenue generated in a base year, as determined by the Department of Revenue. The bill limits these collections to a total of $1 M in each district.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) *Local Option Taxes:* The bill specifies that if a local unit of government adopts a local option tax, the ordinance must be adopted after January 1 and before April 1 of a year and takes affect on July 1 of the year it was adopted. The local fiscal body must send DOR a certified copy of each ordinance adopted by certified mail not more than 10 days after the ordinance is adopted.

Calculations of Welfare Allocation: The provision which changes the calculation of state welfare allocations to be based on county levies for the county welfare fund and the county welfare administration fund, rather than the amounts appropriated from those funds, clarifies how these distributions are to be made and corresponds to the current practice of other local distributions.

ERA: Retroactive to property taxes paid in CY 2000, this bill would allow the Town of Mooresville to grant an abatement if the taxpayer and the town complete all necessary procedures and filings before July 1, 2001. In addition, the taxpayer must have fulfilled all expectations concerning jobs and investment.

One taxpayer has been identified that could qualify for abatement under this bill. The assessed value deduction for CY 2000 would amount to almost $694,000. At the town's CY 2000 net tax rate, the abatement would be worth $61,000. Since this amount would already have been paid, this bill would result in the issuance of a refund. The bill specifies that refunds would not include interest. Property tax refunds are deducted from the affected taxing units' next property tax distribution.

After CY 2000 and through the end of the abatement period, this bill would result in a reduction in the amount of new assessed value added to the tax base in Mooresville. Reducing the tax base causes a shift of the property tax burden from the taxpayers receiving the deductions to all taxpayers in the form of an increased tax rate.

Economic Development Project Districts: If South Bend, Ft. Wayne, and Evansville were to utilize the incremental sales tax provisions in this bill, it could increase local revenue annually by an indeterminable amount. The total amount of sales tax increment is limited to $1 M over the duration of each district. The bill specifies that this revenue could only be used for improvements related to roads, interchanges, and rights-of-way. The city of Ft. Wayne would also be permitted to use the revenue for the demolition of commercial property. In addition, Evansville would be permitted to use the money to acquire, demolish, and renovate housing development property or for physical improvements or alterations of property that enhance the district's viability.

Knox County Innkeeper's Tax: This bill changes the maximum Knox County Innkeeper's Tax rate from 3% to 5%. The current 3% tax raised $115,801 in FY 2001. Based on these collections, an additional 2% will an additional $77,200 annually. Revenue from this tax is deposited in the Tourism Promotion Fund. The increase in the tax is dependent on local action.

Inventory Deduction: This will would reduce the assessed value (AV) of inventory in any county that does not opt out of the phaseout specified in the bill. An AV reduction would result in a shift of part of the property tax burden from the owners of inventory to all taxpayers in the form of an increased tax rate.

The impact on a local government's levy depends on the property tax controls of the fund. There are two basic types of property tax controls: levy controls and rate controls. If the fund is subject to levy controls, then the fund is allowed to raise a fixed dollar amount from property taxes. A drop in the assessed valuation of the fund causes the amount paid by the other taxpayers in the unit to increase to offset the reduction. The fund experiences no loss of revenue, but the other taxpayers' liabilities would increase. Under rate controls, the property tax rate is fixed and a drop in assessed valuation results in less revenue being raised by the levy. The other taxpayers' liabilities would remain about the same. In the case of the school General Fund, the loss in revenue is made up by the state in the form of increased tuition support dollars and is not shifted to other taxpayers.

Inventory Deduction Estimation Issues: In estimating the impact of this provision, special attention was given to the impending real property reassessment. The final rules on real property assessment will have a direct impact on property tax rates and the amount of the property tax levy that will be attributed to inventory. Reassessment will shift some of the property tax burden from personal property owners to real property owners. Due to the uncertainty surrounding the next reassessment and the amount of the shifts, this analysis projects the cost of the credit within a range, using a small shift and a large shift. The smaller total assessed value increase of 25% was based on previous Indiana reassessments while the larger total assessed value increase of 80% was based on the estimated impact of reassessing property using a market value approach. It was also assumed that the next reassessment will apply to property assessed in 2002 with taxes first paid in 2003 as mandated in the latest order from the Indiana Tax Court.

Inventory Deduction Data: According to the State Tax Board's Property Tax Analysis for various years, the net property tax on inventory equaled $402 M in CY 1999. The 1998 pay 1999 inventory assessed value was $4.5 B and has grown at an average annual rate of 4.9% over the last five years. The statewide net average property tax rate was $8.5549 per $100 AV in CY 1999 and $8.6955 per $100 AV in CY 2000.

Inventory Deduction Fiscal Impact: Future inventory assessed values were projected based on historical data and were then reduced to account for credits. Future average net property tax rates were also estimated. Based on estimates of future total tax levies and total assessed values, it is estimated that the statewide average net tax rate will grow at a rate of about 2% per year in non-reassessment years. An estimate of the future net property tax on inventory was then computed by multiplying the estimated net assessed value of inventory by the estimated net average tax rates.

The table below illustrates the possible reduction in the net tax on inventory (and the additional state liability as explained in State Expenditures) if all counties phase out inventory over a 10 year period.

Property Tax Year	% Deduction	Net Tax Reduction on Inventory	Potential State Liability to Schools
2003	10%	$29 M - $42 M	$11.6 M
2004	20%	$62 M - $89 M	$17.0 M
2005	30%	$99 M - $142 M	$26.4 M
2006	40%	$134 M - $193 M	$36.3 M
2007	50%	$179 M - $258 M	$46.8 M
2008	60%	$230 M - $330 M	$58.0 M
2009	70%	$286 M - $411 M	$69.8 M
2010	80%	$333 M - $479 M	$82.4 M
2011	90%	$400 M - $575 M	$95.6 M
2012	100%	$475 M - $682 M	$109.7 M

Although this analysis assumes that reassessment will be effective for property taxes paid in 2003, further legal action could delay the effective date. For this reason, the net tax reduction on inventory was also estimated assuming that reassessment would not take place. Without reassessment, the net tax reduction on inventory under this bill could be as high as $930 M by FY 2012.

CEDIT: This bill would permit a county to use all or part of its County Economic Development Income Tax proceeds to pay for additional Homestead Credits in the county. The bill would also raise the maximum CEDIT rate and the maximum combined COIT/CEDIT and CAGIT/CEDIT rates by an additional 0.25% in each county. The proceeds generated by the additional 0.25% authority would have to be used for additional homestead credits. If all counties adopted the additional 0.25% CEDIT rate, it would generate approximately $252 M statewide. Currently 58 counties have adopted CEDIT. It is estimated that the additional 0.25% CEDIT rate would be sufficient in 91 of the 92 counties to fully mitigate the shift in property tax to homesteaders as a result of the inventory deduction.

Hammond TIF Area: Under current law, the property taxes that are generated by the assessed value that exceeds the base assessed value are redirected to the local redevelopment commission. The base assessed value is the assessed value of real or personal property, or both, on the assessment date before the TIF area is established. The State Board of Tax Commissioners has issued an order that approves an adjustment to the 1999 base assessed value of a TIF district in Hammond. A designated taxpayer in the TIF area has appealed its personal property assessment for the March 1, 1999, assessment date, thereby putting the actual base assessed value and the issuance of TIF bonds into question. The Tax Board's order to adjust the base assessed value removes the uncertainty that prevents the bonds from being issued. This bill would ensure that the authority exists to make the adjustment.

State Agencies Affected: Auditor's Office; Department of State Revenue; Legislative Services Agency; Civil Rights Commission; Department of Commerce.

Local Agencies Affected: Counties; County fiscal bodies; County income tax councils; Local governmental units and school corporations; Town of Mooresville; Morgan County Auditor; South Bend; Knox County; City of Hammond.

Information Sources: Tom Conley, Department of State Revenue, (317) 232-2107; Williams, Graham. "Streamlined Sales Tax for the New Economy," *NCSL Legisbrief* Nov./Dec. 2000; *State Budget and Tax News*, Vol.19, No. 4, February 15, 2000; US General Accounting Office, *SALES TAXES-Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, June 2000, GAO/GGD/OCE-00-165; State Board of Tax Commissioners, *Property Tax Analysis*, various years; Local Government Database.