The County Option

For property tax assessments in 2006, taxes in 2007, Indiana will adopt a statewide 100% inventory deduction. This will remove business inventories from property taxation. Counties can act sooner, if they choose. The County Option Inventory Deduction involves three steps:

- **A 100% inventory deduction.** Inventories will still be assessed for the property tax, but the new deduction subtracts all of this assessed value from the taxpayer’s assessment. That will raise property tax rates for everyone else, if local governments continue to collect the same amount of property tax revenue from the reduced tax base (IC 6-1.1-12-41).

- **Local Homestead Credit.** Counties can add a local homestead credit to the statewide 20% credit, enough to make sure homeowners don’t pay more taxes. An added percentage is subtracted from each homeowner’s tax bill, enough to prevent the average homeowner’s tax bill from increasing. Local government will collect less in property taxes if the credit is adopted (IC 6-3.5-7-25).

- **Local Income Tax (EDIT).** The lost property tax revenue from the added homestead credit can be made up with an added income tax. Counties can adopt or increase their Economic Development Income Tax (EDIT), with a rate high enough to make up for the lost revenue from the higher homestead credit. The county auditor distribute income tax revenues to local governments based on their homestead credit losses, before distributing remaining EDIT revenues in the usual fashion. The maximum added EDIT rate for this purpose is 0.25%. Most counties would have to raise their EDIT rates less than this, in the 0.1% to 0.2% range. (IC 6-3.5-7-5(p)).

Effects on Local Government Budgets

Local governments do not have to raise their tax rates when the local option inventory deduction is adopted. If they do not, their revenues will decline, because the lost revenues from taxes on inventories are not replaced by higher payments by other taxpayers. Local governments that do not raise their rates need not adopt the higher homestead credit nor higher EDIT rate, because there would be no tax shifts to offset.

The June 2002 tax restructuring assumes that local units will raise their property tax rates in order to collect the same tax levy as would have been collected without the inventory deduction. Rates for funds under the property tax controls, and debt service rates can automatically adjust upward. Senate Enrolled Act 464, passed by the 2003 General Assembly, requires the Department of Local Government Finance to adjust maximum rates on cumulative funds and school capital project funds to allow local units to raise these rates to maintain their property tax levies.
This implies that

- Local governments need not lose property tax revenue when inventories are exempted. All tax rates can increase to maintain levies. Local governments can choose to raise their rates less, in order to reduce the size of the tax shift to taxpayers who do not own inventories.
- Local governments need not lose tax revenue if the added homestead credit is adopted. The added EDIT rate is intended to raise income tax revenue to replace the lost property taxes.

**Effects on Taxpayers**

Eliminating inventories from assessed value means property tax rates will rise, assuming local governments maintain their property tax levies. Adopting the added homestead credit offsets added property taxes for homeowners. Adopting the added EDIT rate means county residents pay more in income taxes.

- *Businesses* that own substantial inventories will see tax reductions. The reduction in their assessed values will more than offset the higher property tax rates.
- *Businesses* that do not own substantial inventories will see tax increases. They will pay the higher property tax rates on their existing assessed value.
- If the added homestead credit is adopted at a uniform county-wide rate, *homeowners* in tax districts with substantial inventories will pay higher property taxes, and those in districts with few inventories will pay lower property taxes.
- Senate Enrolled Act 464 allows the homestead credit to vary by taxing district. If the added homestead credit is pro-rated by the shares of inventories in each taxing district, all *homeowners* will break even on their property tax bills. The higher property tax rates will be offset by higher homestead credits. Pro-rating homestead credits would increase the complexity of the tax calculation and billing process for the county auditor and treasurer.
- *Homeowners* will pay more in local taxes overall because of the higher EDIT rate on their incomes. (With a uniform homestead credit, some homeowners in tax districts with few inventories may pay lower taxes overall.)
- *Renters* will pay more in local taxes. Their landlords will pay the higher property tax rate, without much benefit from the inventory exemption. Rental property is not eligible for the homestead credit. Some of these higher taxes will be passed on in higher rents. Renters also will pay the higher EDIT rate on their incomes.
- *Farmers’* property is dominated by land, which will be subject to the higher tax rates, and so would pay higher property taxes. Any farmers with substantial inventories would pay lower property taxes. Farm homesteads are treated the same as those of other homeowners. Under a uniform homestead credit, many farmers would see their homestead property taxes fall, because rural areas are likely to have a smaller share of inventories.

Note that the higher homestead credit and higher EDIT rate can continue after 2007, when the statewide inventory deduction becomes effective.
Effect on Economic Development
The property tax on inventories is a direct business tax. Generally, it is thought that reductions in direct business taxes encourage new business location and investment.

Research for Indiana provides evidence that property taxes do affect the amount of inventories held in Indiana. Lower property taxes are associated with a greater amount of inventory assessments, with each 10% reduction in inventory taxes raising the assessed value of inventories about 4%. Elimination of property taxes on inventories would likely increase the quantity of inventories held in Indiana. (See DeBoer, “Taxing Inventory: An Analysis of Its Effects in Indiana,” Indiana Business Review, Fall 1999. www.ibrc.indiana.edu/IBR/archives.html )

If such development occurs, jobs will be created and employee incomes will rise. In effect, some of the property tax cut businesses receive is passed on to employees in higher wages. Added competition from new and expanded firms would increase the variety of products available to consumers, and reduce prices. In effect, some of the property tax cut businesses receive is passed on to customers in lower prices. The long run effect on taxpayers may differ from the short run effect, to the benefit of taxpayers who do not own inventories.

Adoption Dates

Homestead Credit and EDIT: The county can adopt the added homestead credit and added EDIT rate between January 1 and March 31 of the calendar year in which the deduction is first effective. Adoption in 2004 will offset higher homestead credits for taxes in 2005. The higher homestead credit and EDIT rate can continue in 2007 and after, to offset the effects of the statewide inventory deduction.

The county council can adopt the inventory deduction. The homestead credit and EDIT rate are adopted by the county income tax council in counties with COIT, the county council in counties with CAGIT, and either body in counties with EDIT only or with no local income tax.

Adopting Counties
As of January 1, 2003, 14 counties had adopted the county option inventory deduction. For these counties, the inventory deduction applied for the assessment of March 1, 2003. Inventories will be exempt from taxation in 2004.

5. Fulton  10. Pulaski
**Senate Joint Resolution #5**
The 112th and 113th General Assemblies agreed to a resolution to amend the Indiana Constitution. It will be put to a statewide vote in November, 2004. If passed, this change could alter the timing of the exemption of inventories from the property tax, and could change the method used to exempt them.

Here is the text of the resolution (bold text is added; crossed-out text is removed):

SECTION 2. ARTICLE 10, SECTION 1 OF THE CONSTITUTION OF THE STATE OF INDIANA IS AMENDED TO READ AS FOLLOWS: Section 1. (a) The General Assembly shall provide, by law, for a uniform and equal rate of property assessment and taxation and shall prescribe regulations to secure a just valuation for taxation of all property, both real and personal. The General Assembly may exempt from property tax any property in any of the following classes:

1. Property being used for municipal, educational, literary, scientific, religious, or charitable purposes.
2. Tangible personal property other than property being held for sale in the ordinary course of a trade or business, property being held used or consumed in connection with the production of income or property being held as an investment.
3. Intangible personal property.
4. **Tangible real property, including curtilage, used as a principal place of residence by an:**
   - (A) owner of the property;
   - (B) individual who is buying the tangible real property under a contract; or
   - (C) individual who has a beneficial interest in the owner of the tangible real property.

(b) The General Assembly may exempt any motor vehicles, mobile homes, airplanes, boats, trailers, or similar property, provided that an excise tax in lieu of the property tax is substituted therefor.

The amendment would allow inventories to be exempt from assessment. If passed by the voters in November 2004 the General Assembly could act quickly and eliminate inventories from assessed values in 2005, for taxes payable in 2006. In addition, if inventories are not assessed (rather than assessed and then allowed a 100% deduction), it will be more difficult to measure how much tax rates have increased, how much the added homestead credit must be, and how much the EDIT rate must increase.

You can find additional information on this and other topics at Larry DeBoer’s local government website: www.agecon.purdue.edu/crd/localgov