The Inventory Story

Any day now it will start. The February advertising onslaught, as regular as Groundhog Day: the Inventory Tax Sales.

For the past few years, retailers haven’t been the only ones shouting about the inventory tax. It’s been a big issue in the General Assembly. Your legislators have been doing some shouting, too.

What is the inventory tax? You’ll find no tax on the books with that name. Inventory tax is what we call the property tax on business inventories. The same property tax that applies to your house, at the very same tax rate, also applies to the assessed value of cars on dealers’ lots, corn in farmers’ silos and parts in manufacturers’ warehouses.

The assessment date is March 1. On that day businesses report the value of their inventories, for taxes payable the following year. How do businesses avoid paying taxes on inventories on March 1? Sell them in February!

Fewer than 10 states still tax inventories with the property tax. A lot of businesses would like Indiana to stop taxing inventories, too. They say that Indiana could be a center for goods distribution, since we’ve got so many interstate highways. We discourage firms from keeping goods here because we tax them. But, their opponents say, who will make up the $400 million in inventory property taxes, which go to support schools, counties, cities, towns and other local governments?

The General Assembly debated a phase-out of the inventory tax during the 1999 session. On the last day, it passed a $12,500 assessed value deduction for all personal property—inventories, plus business equipment and even many mobile homes. Unfortunately, this deduction turned out to cost about twice what was expected. The General Assembly repealed it in 2001, in response to the looming budget shortfall.

In its place, legislators passed a new income tax credit. Businesses will pay their inventory taxes but will receive a credit for part of this payment to reduce their income taxes. The credit is scheduled to go into effect in 2003, though the governor’s budget plan calls for it to be postponed until 2005. Either way, this year, 2002, neither the property tax deduction nor the income tax credit applies.

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The ongoing property tax reassessment enters the mix. In decades past when businesses assessed their inventories, they started with their purchase costs, then subtracted 35 percent. Under the new assessment rules, the Department of Local Government Finance (formerly the State Tax Board) will not allow the 35 percent inventory adjustment. The Indiana Tax Court has ordered the department to write assessment rules that are more closely related to property value. And, increasing the assessments of business property will decrease the shift in property taxes to homeowners. Most businesses will still pay lower taxes on their inventories because of reassessment, since tax rates will fall. But the tax cut would have been bigger had the 35 percent adjustment remained.

Then there’s tax restructuring. The Governor’s 21st Century Tax Plan proposes a 100 percent property tax credit for inventory taxes starting in 2003. The plan includes $462 million to be paid to local governments to offset the lost inventory tax revenue. That money comes from higher sales and income taxes.

This is complicated. Couldn’t we just eliminate the property tax on inventories? Avoid having to assess them, avoid paying the hundreds of millions of dollars from state revenues to offset them? We could do that, but the Indiana Constitution seems to require that inventories be assessed and taxed. We’d have to amend the constitution. And, if we reduced assessed value because inventories weren’t assessed, property tax rates would have to be higher to raise the same amount of local revenue. Remaining property owners (like homeowners) would pay those higher rates.

Still, with all these new rules and proposals, it could be that the days of the inventory tax are numbered. One of these years, we’ll see the last of the inventory tax sales. Perhaps we won’t be so nostalgic for the loss of this particular Indiana tradition.

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