

GEORGIA STATE UNIVERSITY
ANDREW YOUNG SCHOOL OF POLICY STUDIES
FISCAL RESEARCH CENTER
SEPTEMBER 8, 2006

SUBJECT: Options for the Property Tax on Inventory

Analysis Prepared by: John Matthews and David L. Sjoquist

Consideration is being given to eliminating inventory from the base of the property tax. This memorandum discusses alternative approaches for doing that. The Georgia Constitution requires that any new exemption of tangible property from the property tax must be approved by 2/3rd majority of each body of the General Assembly and a majority of the voters. The nature of the Constitutional amendment will likely depend upon the approach the State wants to take in exempting inventory.

1. Instantaneous Elimination

The simplest approach is to exempt all inventory from the property tax as of a specific date. Based on a Constitutional amendment allowing an exemption of inventory, the General Assembly could set a date, presumably January 1 of the year following approval of the Constitutional amendment, that inventory would no longer be subject to the property tax.

The implication of this approach is that local governments would see an immediate reduction in property tax revenue unless they raised their property tax rate. On average, the property tax digest will fall by about 6 percent, but with a range of county-level decreases of 0.5 percent to 15 percent. For several municipalities inventory is over 25 percent of their property tax base.

2. Phased-in Elimination

Rather than eliminating the inventory from the property tax base in one full swipe, the State could phase in the elimination. For example, rather than assessing the inventory at 40 percent, the State could reduce the assessment by 2 percentage points each year. This would require 20 years to fully eliminate inventory from the base. Reducing it by 10 percentage points would require 4 years to fully exempt inventory. The benefit of this

option is that local governments would have time to adjust to the lower property tax base.

In 1999, Rhode Island started a 10-year phase out of its property tax on inventory. Ohio has a 25-year phase out of its property tax on inventory.

3. Eliminate Certain Types of Inventory

Rather than eliminating all types of inventory, the State could provide an exemption for certain types of inventory. Currently, the State allows a Freeport exemption for goods in the process of manufacture or production, inventories of finished goods (i.e., goods that have completed production and are ready for sale) produced within the state and held by the producer, and inventory of finished goods stored in a warehouse, dock or wharf that are destined for shipment outside the state. Local governments choose the level of exemption. For the most part, local governments exempt none or only part of these inventories.

The State could require a 100 percent exemption for these two types of inventory. The State could expand the classes of inventory that are allowed under the Freeport exemption. For example, the State could exempt all inventory in warehouses rather than the inventory that is that designated for shipment outside the state. The State could add merchandise (goods that have been purchased for resale) held in distribution warehouses.

4. Provide for an Inventory Property Tax Credit

An exemption of inventory from the property tax obviously affects the revenue of local governments. An alternative is for the State to establish a grant program to fund a credit against the inventory property tax. This would be similar to the Georgia Homeowners' Tax Credit and to Virginia's approach to eliminating its tax on motor vehicles. Under such a program inventory would still be assessed and the tax liability calculated. However, each taxpayer would receive a credit equal to all (or some percentage depending upon the level of funding provided by the State) of the tax liability on inventory. To fund this program the State would provide a grant to each local government equal to the tax liability on inventory for the previous year. If the credit program were to start in say, calendar year 2009, the State would provide a grant at the beginning of 2009 equal to the property tax liability on inventory for 2008. Since the grant may not equal the actual tax liability in 2009, the grant for 2010 would include an adjustment for the extent to which the State grant exceeded or fell short of the tax liability in the previous year.

5. Provide a Replacement Local Tax

In order to reduce or eliminate the revenue effect on local governments from eliminating the property tax on inventory, the State could allow local governments to adopt an alternative revenue source. Indiana, for example, allowed local governments

that eliminated inventory from their base earlier than the State imposed deadline were allowed to increase local income tax revenue to replace the lost property tax revenue. If the State were to allow a new revenue source or an increase in an existing non-property tax source and the revenue more than covered the reduction in property tax revenue from eliminating inventory from the base, the State could consider eliminating other property from the property tax base.

6. Change Assessment Date for Inventory

Unless all inventories are exempted, the State might consider changing the basis for assessing inventory. Currently, the value of inventory is set as of January 1. An alternative that is used in some states is to value inventory on the first of each month and use the monthly average as the basis for property tax. This approach reduces the need to substantially reduce inventory on January 1 in order to reduce the property tax on inventory. It also means that businesses that normally have large inventory around the first of the year are treated more fairly relative to those businesses that need little inventory on January 1.