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Indiana's 2014 Tax Package Continues State's Pattern of Year-Over-Year Improvements

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Introduction

Indiana tax reforms in the past few years have been impressive. In 2011, state senator Brandt Hershman addressed a weak link in the state's tax code by leading a bill that set the corporate income tax rate on a four-year phasedown from 8.5 percent to 6.5 percent.[1] In 2013, Governor Mike Pence worked with the legislature to maintain these corporate rate cuts while instituting a moderate cut in the state's already well-structured individual income tax and speeding up the repeal of the state's inheritance tax.[2]

This year, policymakers have continued the Hoosier trend toward better tax laws, as the governor signed a major tax package on March 25 that will improve the state's business tax climate further. Indiana's reforms to business personal property taxes are of particular interest, as they could serve as a template for tax reform discussions by policymakers in other states. This report lists some major changes in the tax reform bill and the impact they will have on the state economy.

New Law Cuts Corporate Income Taxes and Reforms Business Personal Property Taxes

The new tax law, Senate Enrolled Act No. 1, is a compromise of S.B. 1, originally authored by Sens. Brandt Hershman and Luke Kenley, and H.B. 1001, originally authored by Rep. Eric Turner.

Major components of the package will:

- Phase down the corporate income tax rate to 4.9 percent by 2022, which would make Indiana's the second lowest corporate tax rate of any state levying the tax.
- Allow localities the option to enact a business personal property tax filing threshold for businesses with less than $20,000 in personal property (this threshold is based on acquisition cost of the property).

1 Niki Kelly, *Corporate Tax Cut Praised as Jobs Bill*, Journal Gazette, May 1, 2011, http://www.journalgazette.net/article/20110501/NEWS07/305019873/1067/NEWS07.
2 Joseph Henchman, *Indiana Approves Income Tax Reduction*, Tax Foundation Tax Policy Blog, May 14, 2013, http://taxfoundation.org/blog/indiana-approves-income-tax-reduction.

- Allow localities the option to exempt new property from the business personal property tax.
- Create a designated body that may establish an enhanced personal property abatement schedule on a project-to-project basis.
- Create a business personal property commission of legislators, local officials, and industry representatives to further study business personal property taxes and other business taxes.

Corporate Tax Cuts Further Improve Business Climate

Indiana's recent corporate rate cuts have made it one of the best tax climates in the county. Last year, the state ousted Texas from the top ten of our *State Business Tax Climate Index*, a ranking of business tax competitiveness.[3] As this year's package phases in (Table 1), Indiana is projected to move up from 10th place to 8th place overall. The corporate code subcomponent ranking is expected to improve from 24th to 10th (Table 2).[4]

Table 1: Indiana Corporate Income Tax Decreases, Past and Future

Fiscal Year	Rate
FY 2012	8.50%
FY 2013	8.00%
FY 2014	7.50%
FY 2015	7.00%
FY 2016	6.50%
FY 2017	6.25%
FY 2018	6.00%
FY 2019	5.75%
FY 2020	5.50%
FY 2021	5.25%
FY 2022	4.90%

Note: The Indiana corporate tax year starts on July 1st, the first day of the fiscal year. (e.g. FY 2015 starts July 1, 2014)

Table 2: Indiana State Business Tax Climate Index Ranking under New Law

	2014 Rank	Under New Law
Overall	10	8
Corporate	24	10
Individual	10	10
Sales	11	11
Unempl. Insur.	13	13
Property	5	5

Note: Index run assumes full phase in of the law in place as of the report's snapshot, July 1, 2013. 1 is best, 50 is worst.

Corporate taxes are a relatively small part of state and local tax collections in most states, and Indiana collects just 3.1 percent of state and local collections from the corporate income tax.[5] Empirical studies that distinguish between types of taxes additionally find that corporate taxes are the most harmful to economic growth.[6] Because of this, corporate rate cuts are often a relatively inexpensive way for policymakers to increase economic growth and improve business climate.

3 Scott Drenkard & Joseph Henchman, *2014 State Business Tax Climate Index*, Tax Foundation Background Paper No. 68 (Oct. 9, 2013), http://taxfoundation.org/sites/taxfoundation.org/files/docs/2014TaxFoundationIndex_FINAL.pdf.

4 Scott Drenkard, *Indiana Senate Tax Reform Proposal Would Improve Business Tax Climate Ranking*, Tax Foundation Tax Policy Blog, Jan. 9, 2014, http://taxfoundation.org/blog/indiana-senate-tax-reform-proposal-would-improve-business-tax-climate-ranking.

5 Lyman Stone, *Facts & Figures 2014: How Does Your State Compare?* (Mar. 18, 2014), Table 8, http://taxfoundation.org/article/facts-figures-2014-how-does-your-state-compare.

6 William McBride, *What Is the Evidence on Taxes and Growth?*, Tax Foundation Special Report No. 207 (Dec. 18, 2012), http://taxfoundation.org/article/what-evidence-taxes-and-growth.

Further, economists agree that corporate taxes are ultimately not borne by corporations themselves, but are passed on to consumers in the form of higher prices, workers in the form of lower wages, and shareholders in the form of lower dividends.[7] As the state moves to the second-lowest corporate rate in the country (of the states that levy the tax), it will be more attractive to businesses looking to make location changes.

Indiana Business Personal Property Tax Reform is a Model for other States

States have moved away from tangible personal property taxes in recent years. Between 2000 and 2009, collections per capita have declined by 20 percent. Seven states (Delaware, Hawaii, Iowa, Illinois, New York, Ohio, and Pennsylvania) have eliminated tangible personal property taxes entirely and four states (Minnesota, New Jersey, North Dakota, and South Dakota) tax very little tangible personal property.[8]

This movement away from tangible personal property taxes is good policy, because these taxes distort the market by subjecting capital and machinery to taxes that labor inputs are not subjected to. In the long run, this puts a penalty on cost-saving, innovative investments.

However, the way states have gone about eliminating tangible personal property taxes has been a mixed bag. A recurring challenge is the conflict of using the state legislature to reform a tax that is relied on for local revenue. Municipal leagues are quick to send lobbyists to the state capitol to halt reforms, even if the reforms are good policy.[9]

In Ohio, the tangible personal property tax was removed in 2005 and replaced by state revenues from a new (and arguably worse) gross receipts tax called the Commercial Activities Tax.[10] In Illinois, the tangible personal property tax was repealed and replaced by a statewide additional 2.5 percent corporate income tax that stacks on top of the already high 7 percent state rate. Sources sometimes neglect to mention the 2.5 percent add-on corporate income tax, misrepresenting the corporate rate that Illinois businesses face.[11]

Indiana's approach, by contrast, gives autonomy to localities to enact a filing threshold for businesses with small amounts of capital (less than $20,000 in acquisition costs) or to exempt new property (which phases down the tax base as old property is retired). Both of these help localities compete against

7 Department of the Treasury, William A. Gentry, *A Review of the Evidence on the Incidence of the Corporate Income Tax*, OTA Paper 101 (Dec. 2007), http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/ota101.pdf.

8 Joyce Errecart, Ed Gerrish, & Scott Drenkard, *States Moving Away from Taxes on Tangible Personal Property*, Tax Foundation Background Paper No. 63 (Oct. 4, 2012), http://taxfoundation.org/article/states-moving-away-taxes-tangible-personal-property.

9 Mary Milz, *Mayors Oppose Indiana Move to End Business Personal Property Tax*, WTHR 13, Feb. 18, 2014, http://www.wthr.com/story/24693449/2014/02/11/mayors-oppose-indiana-move-to-end-business-personal-property-tax.

10 *See* Errecart et al., *supra* note 8, at 11.

11 Joseph Henchman, *Many Sources Misreporting Illinois Corporate Tax Rate*, Tax Foundation Tax Policy Blog, Jan. 14, 2011, http://taxfoundation.org/blog/many-sources-misreporting-illinois-corporate-tax-rate.

neighboring states with lower personal property tax burdens, but only if they so choose.

The filing threshold provision deserves special mention as an innovative policy solution. If localities enact this option, they will entirely eliminate the compliance costs for small businesses that file tangible personal property taxes. The business personal property tax forms include calculating all assets and depreciating them according to schedules, a process that causes unnecessary taxpayer headache for what amounts to a small amount of tax collections in the case of small businesses.

In these reforms, Indiana has given localities options to move away from a damaging tax while staying away from poor revenue replacement mechanisms that have crept into reform attempts elsewhere. Other states can look to Indiana as a model for healthy, viable tangible personal property tax reform.

Conclusion

The tax reform efforts in Indiana deserve special recognition as a success at cutting corporate income taxes and reforming personal property taxes in inventive ways. Policymakers reached compromise despite varying approaches and ended up enacting policy that could serve as a starting point for discussion in other states.

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