

Commercial Property Tax Task Force

**Report to
The Honorable Chet Culver
State of Iowa**

January 2007

January 26, 2007

The Honorable Chet Culver
State Capitol
Des Moines, Iowa 50319

Dear Governor Culver:

The Commercial Property Tax Task Force you appointed in December 2006 is pleased to submit its final report. The growing inequities between taxes on commercial property and other classes of property is a critical issue. We want to express our appreciation to you for addressing it as one of your first agenda priorities as Iowa's Governor. In addition, we want to especially thank the Task Force members who diligently listened to many individuals and interest groups, brought forth their own experience and expertise, and actively discussed the issues that led to the recommendations in this report.

Our timeframe was limited and our charge was specific. With that in mind, the Task Force makes recommendations specifically to address to an extent, the inequities for Iowa's commercial property tax payers. The Task Force desires to "stop the bleeding" of commercial property tax payers and send all tax payers a clear message that more needs to be done.

It also became very apparent in our early discussions that the tax system as a whole in Iowa has suffered as a result of years of "tinkering and adjusting" in an effort to alleviate certain inequities between the classes of property. It is also apparent, that over the years, other legislative adjustments have complicated the system even more. In every presentation and communication to the Task Force, there were suggestions that a major analysis and revision of our complete tax system is immediately in order.

Given that the last major tax system revision took place in 1978, there is a legitimate pent-up demand to address our tax system as a whole. This report provides a level of redress for commercial property tax payers in the state for a two year period. The Task Force is looking to you to use your position to encourage investment of resources possible at this time to implement the commercial property tax recommendations and implement a longer-term study to create a 21st Century tax system for Iowa.

Respectfully submitted,

Teri Hawks Goodman
Co-Chair

Michael King
Co-Chair

Governor Culver's Charge to the Task Force

The Commercial Property Tax Task Force is appointed to introduce an examination of Iowa's property tax system and, in particular, the matter of equity of the relationship between taxes on commercial property and those on other classes of property. This group will make recommendations to the Governor on the matter of commercial property tax inequities and possible solutions.

Commercial Property Tax Task Force Members

Teri Hawks Goodmann, Task Force Co-Chair – Mississippi River Museum; Chair, Dubuque Regional Airport Commission; Member, Dubuque Initiatives Board

Michael King – Task Force Co-Chair; Union County Supervisor; Member, Iowa State Association of Counties Board of Directors

Preston Daniels – Realtor; Former Mayor of Des Moines

Debi Durham, President, Siouxland Chamber of Commerce

Dennis Ausenhus, representing Ric Jurgens – President and Chief Executive Officer, Hy-Vee, Inc.

Michael Kiernan – Member, Des Moines City Council

James Kurtenbach – Story County, State Representative; Faculty Member, Iowa State University

Don Shultz – Black Hawk County, State Representative

Dan Smith – Attorney; Consultant, City of Coralville and Coralville Home Builders Association

Task Force facilitation services were provided by State Public Policy Group, Inc. of Des Moines – www.sppg.com

The Task Force expresses its appreciation to the Iowa Department of Revenue, the Iowa Department of Management, the Iowa Legislative Services Agency, and the many citizens, organizations, and associations that provided information and input. An Appendix of meeting notes and a list of contributors of information provided to the Task Force is available under separate cover. The Task Force Report and Appendix are available on the Commercial Property Tax Task Force web site at <http://www.governor.iowa.gov/issues/comm-prop-tax.php>.

Overview

Over time, the Iowa tax system created a disproportionate tax burden on commercial property as compared with other classes of property. This shift puts commercial property tax payers and Iowa's businesses at a distinct disadvantage when compared to other states. To address this issue, Governor Culver created a nine-member citizen Task Force to bring forth recommendations to address the inequities between commercial property taxes and other classes of property tax.

The Iowa tax system is broken as a result of many years of "tinkering and adjusting." That being obvious, the Task Force feels strongly that a 21st Century Tax system must be created and the work and policy decisions to do so must be completed by 2009. This effort demands strong leadership, political will, public transparency, and hard work by Governor Culver and the General Assembly. This will succeed only if it is a bi-partisan effort.

The Task Force was given 30 days to meet and make recommendations. In an open and transparent process, interested stakeholders and the public provided information and perspective to the Task Force. It became clear at the outset that commercial property taxes are inextricably linked with other taxes, and while the Task Force charge was to address commercial tax inequities, it was very apparent this work was a first step in a broader examination of Iowa's property tax system. The Task Force decided to set aside the many additional, though important, issues in order to address the specific charge from the Governor.

In deliberations, including receiving public input, the Task Force discussed a number of broader property tax issues. Some were considered as a means to provide some level of immediate relief to commercial property tax payers, while others addressed the causes and effects of the current Iowa property tax system. The Task Force recognized, as a result of the evolution of the tax system over the years, policies and programs were specifically created as a means to address dysfunctional elements of the property tax system.

In considering the charge, the Task Force brought forth concepts to provide immediate and direct relief to commercial property tax payers through funding at whatever level is possible and is determined by policymakers. One proposal discussed would provide a direct and immediate commercial property tax credit through the state income tax filing of commercial property owners in conjunction with a two-year freeze of the residential rollback and eventual decoupling

of residential and agriculture valuations. There was discussion that the state of Iowa would provide more support to the counties for certain services, which would allow the counties to pass on a tax reduction to local commercial property tax payers. The Task Force agreed that properties that are currently tax-exempt could provide alternative solutions for local commercial property tax relief.

Change in the status quo for the commercial property tax structure and setting the stage for a more strategic and holistic reform of the tax system were the clear expectations of the group. The Task Force felt strongly about making specific recommendations for immediate action and to include additional recommendations to be considered the highest priority issues in a two-year comprehensive tax study. The Task Force expressed in very certain terms that the immediate recommendations and the priorities for the study are essential in creating a fair 21st century tax system for the state of Iowa.

Immediate Recommendations

To “stop the bleeding” and to start on a path to address the inequities for commercial property tax payers is foremost. The Task Force recommends immediate action be taken by the Governor and General Assembly on the following items as a way to prevent worsening inequities and to provide immediate tax relief to commercial property tax payers, as well as ensuring there are no immediate increases in other classes of property taxes. To not link these immediate recommendations, along with the priorities to be included in a two-year comprehensive tax study would be a major failing for the Task Force and Iowans.

The Commercial Property Tax Task Force requests the Governor and General Assembly consider the following recommendations. Each of these recommendations would have a positive impact on the inequities facing commercial property tax payers and provide a level of immediate tax relief to commercial property owners. The Task Force further urges policymakers to dedicate resources to the level possible to fund the selected strategies.

Commercial Property Tax Refund Strategy

- **Provide commercial property tax relief to the extent possible to commercial property owners by means of a commercial property tax refund reported on income tax forms and paid as a property tax refund.**

Rationale: This strategy targets commercial property owners and provides direct property tax relief to this class only in a manner that has immediate impact. Reporting and distributing relief through the state tax system protects local government from additional administrative burden and keeps property tax owners from waiting 18 months to receive a benefit. This strategy provides an equal dollar benefit for every business owning commercial property.

Education Funding Strategies

- **Continue investing resources in accordance with the 2006 legislation which focuses on equalization of the disparities among school districts.**

Rationale: This recommendation provides a level of relief to all classes of property tax, while providing a greater level of relief to commercial property owners. In addition, this strategy equalizes the tax impact between school districts. Targeting state funds to the extent possible to this strategy would continue the trend toward equalizing these tax levy rates that was begun in 2006.

- **Increase the state's share of K-12 education funding from the current 87.5% to 88.5% in Year 1 and to 89.5% in Year 2, with a goal of the state paying 95.0% by 2012.**

Rationale: Increasing state equalization for K-12 education funding one percent, to 88.5 percent in Year 1 will generate approximately \$25 - \$30 million in total property tax relief across all classes of property. Commercial property taxes account for nearly 25% of local property tax revenue, meaning roughly \$7.5 million or 25% of the relief will go back to tax payers if the residential rollback does not increase and the agricultural productivity formula does not fluctuate greatly. The equalization share of K-12 funding will increase to 95% over the course of five years, which will provide significant long term relief largely to commercial property owners and also to the other classes of property.

- **In conjunction with increasing the equalization formula described in the previous recommendation, in Years 1 and 2, increase the uniform school levy from \$5.40 to \$6.50 or \$7.50, depending on projections generated by Iowa Department of Revenue.**

Rationale: Increasing the uniform school levy from \$5.40 to \$6.50 or \$7.50 and increasing the equalization percentage will provide commercial property tax relief by increasing the state share of education funding, which results in a proportionately smaller total property tax burden across all classes of property locally. If the uniform school levy is increased by \$1.10 or \$2.10 in

conjunction with an increase in the state's share of K-12 education funding, much of the second effort required by counties to fill the remaining education funding gap will be reduced or nearly eliminated, providing greater tax relief to the commercial property owners than to other classes of property.

21st Century Tax System Study

It was pointed out by Task Force members and presenters that Iowa's tax system has been studied many times and little happened as a result of any study or recommendations. The Legislature has not revised the tax system which has been constructed, renovated, and re-renovated over the last 50 years. Recent bi-partisan efforts have moved issues incrementally forward.

Continued incremental action or no action is not acceptable to this group. The Task Force, in recognizing there are myriad issues to be addressed and changed, recommends a two-year study that engages citizens, legislators, and all Iowa stakeholders in a bi-partisan and very transparent way. In establishing the new and transparent process to include a study and task force effort, some consideration should be given to inviting interested members of this Commercial Property Tax Task Force to continue in service. This study will require an appropriation adequate to solicit, through a Request for Proposals process, a qualified and well-respected tax specialty firm to conduct a fiscal analysis and provide data to support a 21st Century Tax System Task Force process and provide for specific recommendations by December 15, 2009.

Tax Study Priorities

Recommending that agricultural and residential property values be disconnected was carefully considered as an immediate recommendation to the Governor. The Task Force recognized the impact and inequities that coupling these classes cause in the current property tax system. Although a majority of the Task Force members supported decoupling agricultural and residential values as an immediate recommendation, there was not a clear consensus. That, as well as a concern about the impact this recommendation might have on residential property tax payers, puts the decoupling of agriculture and residential property taxes as the first issue to be considered in the tax study.

There was unanimity among Task Force members to include these specific priorities as core issues in a two-year comprehensive tax study. Clarifying what property taxes pay for is important to tax payers. Across the state, there are tax-exempt properties that require local services, but local government is unable to recoup the cost of providing those services. Iowa embraces local government and school districts, but it is important that there are incentives and opportunities to encourage more efficiency and cost sharing. As noted many times, in many ways, “our current tax system is broken and needs to be fixed.”

1. Decouple agricultural and residential property valuations and limit all classes of property to 2% increases and decreases annually.

Rationale: Without question, this was the core issue in considering the Task Force’s immediate recommendations. A slim majority of the Task Force supported decoupling agriculture and residential property and endorsed it as a part of the recommendation which injects additional state funding into the school aid formula. But there was apprehension by some, for fear an unexpected consequence may result in an increase in amounts of residential property taxes. But the Task Force agreed the landscape and economic structure of Iowa has changed. The way in which Iowans farm and produce livestock and grain is much different than 30 years ago. New kinds of industry and new technology and energy-creation investment and production across the state require another way to look at how agriculture and residential property tax are valued. The Task Force reached consensus to include decoupling residential and agricultural valuation as the first, and most important, issue to be considered in the tax study.

2. Create a more transparent property tax system.

Rationale: It seems very difficult in the current system for most tax payers to understand exactly who may be responsible for increasing or decreasing property taxes or what property tax revenues are used to pay for. Over time, and for a variety of reasons, Iowa’s current tax system has become a confusing maze. It is expensive and onerous to adjust and make adaptations. First steps have been taken with the statewide appeals board, and the Department of Revenue should be authorized to take measures to ensure consistency in the valuation process across the state. Over the years, the level of complexity has made the system difficult to administer, and the system makes very little common sense to most. The Task Force is convinced there must be a better way. An overarching priority in the proposed tax study is to simplify the system. While 21st century technology will continue to allow for some improvements, the Task Force is

concerned about improving transparency for Iowa tax payers. Simplifying and clarifying how government determines and spends tax payers dollars will save time and money and may eliminate some of the “finger pointing” and confusion.

3. Improve efficiencies through sharing of local governmental services.

Rationale: Iowans look to their local communities and schools with great affection and loyalty. Iowans also believe that government and education should be of quality and efficiency. The Code of Iowa allows local government entities to enter into agreements (28E) to work more closely together to improve efficiency and services. But with the press of property taxes, more needs to be done. Local government is also constrained in what and how revenue is generated. With this and the changing population patterns in the state, it is critical that state incentives are developed and provided to encourage local governments to join together in expanding, creating, and implementing efficiencies without cutting services. It is imperative that this issue is a part of the tax study.

4. Review and analyze properties exempt from property tax.

Rationale: Across the state and in some concentrated regions, there are institutions and organizations that are tax exempt. In some communities, certain tax-exempt entities voluntarily pay for some local government services, but in most communities and counties, the costs for services are shifted to local government who must pass the cost of these services on to property tax payers. Local governments have no recourse. While some suggest that these tax-exempt properties make up for the tax loss by improving the local economy, often that is not case. Allowing local governments the authority to put in effect appropriate ordinances to address tax-exempt organizations would provide for local control which would allow decisions to be made in the best interest of the local property tax payer and tax-exempt institutions.

Other Critical Issues

There were a number of other issues discussed by the Task Force over its four day-long meetings. Presenters brought forward concerns that promulgated a number of critical issues that resonated with the Task Force as a result of Iowa's current tax system. In recommending the creation of a two-year comprehensive tax study, the Task Force brings the following critical issues forward and urges their consideration. These issues are not in any priority order.

- Review mobile home and manufactured housing property tax issues.
- Consider a new class of property to address the inequity between apartments and the class which includes condominiums and duplexes.
- Assist counties by shifting more mental health costs to the state.
- Examine tax increment financing (TIF) practices.
- Review how agricultural property tax is assessed and valued.
- Determine a fair method for taxing agricultural buildings.
- Improve methods at the state to more accurately determine tax policy impact.
- Examine how local governments could create revenue streams to offset property taxes.

Conclusion

Tax reform is a complicated issue. The Commercial Property Tax Task Force takes a first step with its recommendations. Reform is a monumental undertaking that requires leadership from the Governor, bi-partisan support in the legislature, and a healthy discussion with Iowans. The Task Force's charge is to recommend steps to reduce the inequities between commercial property tax and other classes. Implementing these immediate recommendations will be a major first step by providing a benefit to commercial property owners and, in some cases, to all classes of property. Investing available resources to implement recommendations this year will "stop the bleeding" for commercial property tax payers. Creating a 21st Century Tax System Study, focused on the Task Force Priorities, will provide a long-term solution to a tax system in need of critical reform.