9-14-1979

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REPLACEMENT OF THE PERSONAL PROPERTY TAX
by
Philip Favero, Assistant Professor of Economics

During the 1978 and 1979 sessions, the South Dakota State Legislature repealed the state's locally-assessed personal property tax. Tax payments for household goods, personal effects, home appliances and sporting goods were lifted in 1979. In 1980, other locally assessed personal property, including business inventories, agricultural machinery, and livestock, will not be taxed. This issue of the Economics Newsletter contains answers to five questions commonly being asked about the repeal of South Dakota's personal property tax and about the method for replacing lost revenues.

Five Common Questions

1. WHAT WAS THE SIZE OF THE PERSONAL PROPERTY TAX?

For the past several years, personal property taxes have totaled about $40,000,000, or approximately twenty percent of all property taxes collected. Repeal of the personal property tax thus substantially reduces revenues from property taxes—the largest single source of funds for South Dakota's local units of government.

2. WILL LOCAL UNITS OF GOVERNMENT BE REIMBURSED FOR REVENUES LOST?

Yes. The legislature provided approximately $40.7 million to annually reimburse local units. Two optional formulas are to be used. Counties will receive the higher of either personal property taxes assessed in 1977 and payable in 1978 or 95 percent of the average personal property taxes assessed from 1972 to 1976 and payable from 1973 to 1977. Optional formulas were chosen to protect those counties whose personal property taxes were substantially reduced for livestock selldowns in 1976. Although a formula was devised for additions to the $40.7 million annual reimbursement, any additional funding will need to be established by the state legislature. No provision was made for automatic growth in reimbursements to local units.

3. HOW WILL THE PERSONAL PROPERTY TAX BE REPLACED?

A variety of tax sources will be used, effective in July 1979 and including:

- An increase in the franchise tax on financial institutions such as banks and savings and loan associations to six percent from five and one-half percent of net income;
- An increase in the insurance premiums tax on domestic companies from one-half to three-quarters of one percent;
- An increase in license fees for securities agents and brokers to $125 and $150 from $15 and $100 respectively;
- An increase in the cigarette tax by two cents a pack;
- A broadening of services covered under the four percent sales tax to include a variety of personal services such as automotive repairs and services provided by real estate agents;
- A new four percent tax on the gross receipts of contractors providing realty improvement services (for contracts bid after 1 June 1979). Receipts of subcontractors and sales taxes paid on materials are exempted from the tax;
- A new four percent tax on receipts for "realty improvements performed without contracts" which are sold within four years of the improvement.
These new or expanded tax sources are expected to generate approximately $20 million during the first full year. The net balance of replacement monies will come from the general fund.

4. WHAT IS MEANT BY A "REALTY IMPROVEMENT WITHOUT A CONTRACT?"

Regulations are currently being written by the Department of Revenue. Indications are that the law will be interpreted narrowly and applied to commercial developers who make improvements on their own land.

5. CAN WE PREDICT WHO THE Gainers AND LOSERS OF PERSONAL PROPERTY TAX REPLACEMENT WILL BE?

Farmers and ranchers are the biggest direct gainers. About one-half of all personal property revenues collected in 1978 ($18.8 million) resulted from taxes on livestock and agricultural machinery and tools. Retail businesses also directly gain from the removal of the tax on inventories, fixtures and equipment. Businesses paid about $6.4 million in taxes on inventories in 1978.

Losers include those who contract for realty improvements or who buy new buildings. Assuming that the tax will be passed along to purchasers and that labor contributes fifty percent of realty improvement costs, the price for buildings and improvements will increase by about two percent. Extensions of the sales tax to cover other personal services are also likely to increase the prices of those services.

Conclusion

Repeal of the personal property tax eliminates an unpopular tax for South Dakota. But the repeal puts a heavier burden for revenue production on the state's sales tax. Little further broadening of the sales tax seems possible and the four percent rate is unlikely to be increased, given equal or lower rates in neighboring states. Such pressure on the sales tax comes during an inflationary period in the national economy. The state government, as a purchaser of goods and services, faces escalating costs similar to those faced by private households and businesses.

Inflation is evident also in prices paid by local governments for their purchases. But the annual replacement for local units of government for revenues lost with the repeal of the personal property tax contains no automatic growth provision. Thus, pressures are likely to increase also for more revenue from real property taxes.