

Phasing Out the Annual Tax on Business Supplies



SUMMARY

State and local governments, like the federal government, have dozens of available options to generate revenue through taxation and fees, many of which are unknown to the average person. Government officials should strive to make these obligations equitable, transparent, and avoid counterproductive taxes.

One such tax that has missed the mark is Utah's annual tax on business supplies—the Tangible Personal Property Tax, which violates nearly every principle of fair tax policy.

To comply with this tax, business owners must annually tally up their supplies and use a number of confusing depreciation schedules to determine how much they owe. The relatively small amount of revenue generated does not justify the wasted time and effort to repeatedly report and pay this inequitable tax.

As state governments move away from taxes on business inputs that discourage investment and, consequently, economic growth, this is one of the taxes that must be eliminated.

Business owners in Utah need to be freed from the double taxation and burdensome compliance costs of the Tangible Personal Property Tax.

This policy brief will outline the many taxes businesses already pay and how the annual tax on business supplies does not follow the principles of good tax policy. Several reasonable solutions will be offered for the partial or complete elimination of this tax in order to allow Utah businesses to thrive in an improved tax environment.

A Brief History

Business taxes in Utah started long before statehood, beginning with a property tax imposed by the General Assembly of the provisional state of Deseret in 1850. This new tax, which was eventually adopted by the territorial legislature, applied to tangible personal property, improvements to real property, and intangible property in the form of money loaned or on hand.¹

Prior to the 20th century, state and local governments depended heavily on property taxes for most of their revenue. This type of tax (including tangible personal property) is a colonial-era tax that continues to exist in a majority of states.

When the Utah Constitution was drafted and adopted, tangible personal property taxes were included, not only for businesses, but for individuals and households as well; residents had to pay property taxes on their personal possessions.

By 1918, exemptions had been made for mortgages and household personal property. It proved too difficult to tax the property of individuals and homesteads because much of the property was mobile and could be easily hidden from tax collectors.

In 1931, Utah established a Corporate Franchise and Income Tax (along with an individual income tax). This was followed by a sales tax in 1933 and a use tax in 1937.² These taxes were introduced as an alternative to drastically increasing property tax rates during the Great Depression to fund government functions, especially public education.

The specific rates of these taxes have fluctuated over time, but in general they have increased significantly since their inception.

What Is the Tangible Personal Property Tax?

The Tangible Personal Property Tax (TPPT) is often defined by what it is not. It is not a tax on land or buildings, nor is it applied to securities, patents, or cash. TPPT applies to touchable, movable property. In Utah, counties collect a total of about \$200 million from this tax each year.

Common items that are subject to this tax include furniture, equipment, machinery, electronics, and so on. Household-type items like kitchen appliances and yard equipment have been exempted from TPPT

for businesses, unless they are used by the business to produce income. Because it is levied only on business owners, the average person is generally unaware of TPPT's existence.³

TPPT has now become a bona fide business tax, legally required to be dealt with on a yearly basis by entrepreneurs. Many small businesses in Utah are actually exempt from the tax because the aggregate taxable value of all of their tangible property is less than \$10,000, but they are still required to report this every year to the local county assessor. Should they fail to annually submit this exemption notice, then the business owner can be penalized.

Non-exempt businesses must continue to track every item of tangible property as well as its fair market value. Because the value of tangible assets decreases over time due to use, wear, or obsolescence, businesses have the option of using a depreciation schedule to slowly remove certain items from the list of property the business must pay a tax on each year. As the value decreases, less tax needs to be paid on that asset.

An Inequitable Tax

TPPT is a straightforward example of **double taxation**. At the time of purchase, a business will typically pay a sales tax on the property being acquired. Each year thereafter, the business must pay TPPT on the depreciated value of that item until it either disposes of or sells the item. According to this scheme, a business may pay taxes on a given piece of equipment not just once, but perhaps a dozen or more times.

This pioneer-era tax requires business owners to pay annual taxes on items for which they were already taxed at the point of purchase.

Another unfair aspect of this tax is that different business models will be taxed differently under TPPT. For example, if a business is mostly service based, with little equipment, that business would pay very little in TPPT. But a business that has lots of machinery and equipment will pay much more in TPPT.

One such business, among many, is Momentum Recycling. They engage in glass recycling in Utah and Colorado. John Lair, their CEO, testified before a legislative committee that the TPPT is inequitable because businesses with a similar revenue profile in other industries don't have to pay nearly as much. Momentum Recycling uses quite a bit of equipment to process the glass and paid \$32,000 in TPPT in 2016.

Mr. Lair testified that he had to lay off an employee and even borrow money in order to pay the tax. He also revealed that the tax is not enforced in a uniform manner in Utah. Some businesses pay, while others only pay when an auditor shows up. Some business owners have no idea that the tax even exists until they are audited.⁴

This leads to another point of inequity in the current system. Because TPPT is collected by each of Utah's 29 counties, the way the tax is enforced is often different. Some counties are more lenient, while others are much more strict and tend to audit more often (and for a large corporation, these audits can take months). Depending on which county a business locates in and how important those tax revenues are to said county, the enforcement of the TPPT against a business may be different.

These types of inequities may lead businesses to alter their behavior and decision making. Perhaps instead of buying new equipment, a company might choose to hire another employee or simply choose not to expand in the state at all. These types of financial questions weigh heavily on smaller businesses who are often faced not just with cost concerns, but disproportionately heavy compliance burdens that their larger competitors can more easily accommodate.

Small Business Frustration

Every business, big or small, experiences burdensome compliance costs in paying TPPT. Business owners spend a great deal of time, energy, and money to pay this annual property tax. For a large business, this may mean adding to the list of assignments for in-house accountants or hiring an outside firm to ensure compliance. For a small business owner, it presents an even greater challenge.

updated : 11/13/2018

TABLE 1

FOR CLASSIFICATION GUIDE

2019 Personal Property Percent Good Valuation Schedules by Class

YR	Class																																				
	1	2	3	5	6	8	10	12	13	15	16	17	20	21	24	25	28	SHORT LIFE PROPERTY	COMPUTER INTEGRATED	SHORT LIFE EQUIPMT	FURNITURE & FIXTURES	HEAVY & MED DUTY TRUCKS	MACHINERY & EQ and MEDICAL & DENTAL EQ	RAIL CARS	COMPUTER HARDWARE	HEAVY EQUIPMENT	SEMICONDUCTOR MANUFACTURING	LONG LIFE PROPERTY	YACHTS & HOUSEBOATS	OIL & GAS EQUIPMENT	COMMERCIAL TRAILERS	LEASEHOLD IMPROVEMENTS	AIRCRAFT TOOLING	NON-CAPITIZATION			
2019					90%							90%																									
2018	72%	91%	86%	92%	71%	94%	96%	62%	49%	47%	96%	67%	95%	85%	94%	86%	75%																				
2017	42%	81%	70%	84%	66%	87%	91%	46%	47%	34%	94%	64%	87%	82%	88%	70%	25%																				
2016	11%	70%	53%	74%	61%	79%	84%	21%	44%	24%	89%	62%	81%	74%	77%	36%	0%																				
2015		59%	35%	64%	56%	71%	78%	9%	42%	15%	85%	60%	74%	69%	71%	19%	0%																				
2014		48%	18%	55%	51%	64%	73%	7%	39%	6%	82%	57%	67%	61%	65%	4%																					
2013		38%		45%	45%	56%	68%		37%		79%	55%	61%	59%	54%																						
2012		25%		34%	40%	47%	60%		32%		69%	50%	46%	53%	48%																						
2011		13%		23%	35%	38%	54%		30%		64%	48%	34%	50%	42%																						
2010				12%	30%	30%	48%		28%		59%	43%	27%	46%	36%																						
2009					20%	21%	42%		25%		57%	41%	19%	41%	30%																						
2008					15%	11%	35%		23%		51%	39%	10%	36%																							
2007					10%		28%		20%		45%	36%		30%																							
2006					4%		20%		9%		13%		38%	34%	25%																						
2005							9%		13%				30%	32%	17%																						
2004													23%	29%																							
2003													15%	27%																							
2002													8%	25%																							
2001														21%																							
2000														17%																							
1999																																					
1998																																					

Utah State Tax Commission
Property Tax Division
iii

The official—and complex—depreciation schedule for tangible property in Utah.

Take Kent Forbush, for example. Kent lives in southern Utah and has a small leather-working business creating attractive wallets, gun holsters, and belts. What started out as a hobby became a way to earn a modest amount of additional income. Kent originally purchased his equipment using funds earned from his full-time job.

Kent was notified by his county that he needed to pay TPPT. Confused at first about this new tax, he went to the county assessor’s office to learn more. He was met with dozens of questions about the value of his sewing machine, computer, and hand tools. He was told that he must keep a record of the value of all equipment he used, including his needles and thread.

Kent was instructed that not only was it his responsibility to know when he bought each item and at what price, but that he also needed to become knowledgeable about the different depreciation schedules and associated property categories. How else could Kent determine how much money he owed the government each year for TPPT?⁵

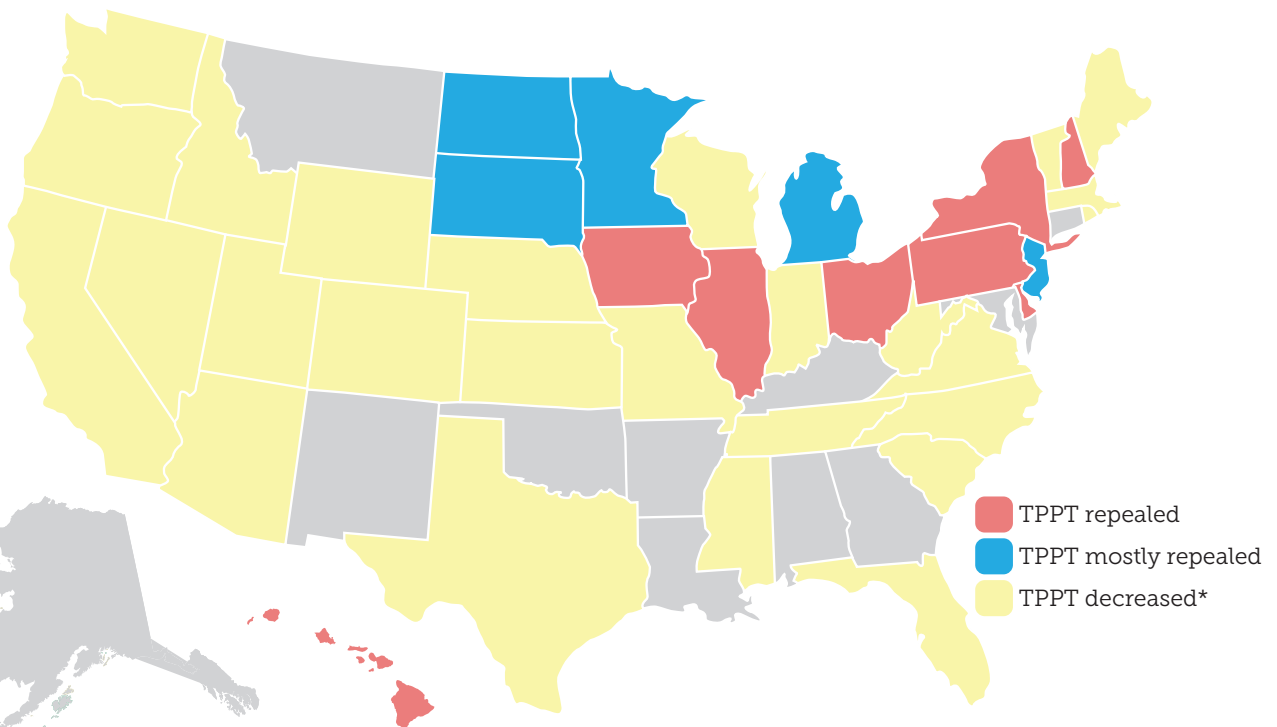
One of TPPT’s biggest problems—aside from the injustice of paying annual taxes on property that has already been taxed at the point of sale—is that it is an “active” tax as opposed to a “passive” tax. When a person pays property tax on their home, for example, they simply receive a bill in the mail telling them exactly how much they owe; this is a passive tax not requiring the

person to do any active calculations or assessments. TPPT, on the other hand, requires the taxpayer to do quite a bit of work just to determine how much they owe.

As with any tax, business owners can be audited at any time to ensure correct compliance. This often means busy entrepreneurs must take a day or more to display their property to an auditor—valuable time not spent running and growing their business. **Too often the additional revenue collected via the audit does not even pay for the cost of the audit itself.** Local governments end up spending a dollar to collect a dime.

Due to the invasive nature and high compliance costs associated with this

TPPT Across the USA



*TPPT Collections as a Percent of Revenue, as of 2009, compiled by the Tax Foundation

tax, there is often non-compliance by small business owners who prefer to wait until a potential audit to pay whatever they might owe, rather than deal with the headache that comes from counting staplers and chairs.

If one were to study the compliance and auditing costs spent on the TPPT in Utah, they would most likely find that it comes out to more than the \$200 million that's actually collected.

Principles of Fair Taxation

When determining what makes sound tax policy, the Tax Foundation, a national nonpartisan tax research think tank, has suggested four key principles: simplicity, transparency, neutrality, and stability. A brief investigation shows that the TPPT violates at least three of these principles.

Unlike many other taxes, TPPT requires taxpayers to proactively track property, calculate its value, and ultimately determine how much tax they owe. The range of capital investments that business owners must keep track of is immense, ranging from laptop computers to office equipment, heavy machinery, and vehicles. Simply understanding which type of property has to be tracked and included is itself a burden. Add in the need to use multiple depreciation schedules along with fair market value analyses, and **simplicity** becomes the antithesis of this tax.

Like all business taxes, the costs of TPPT will mostly be passed on to consumers in some form or another. But unlike a sales tax or a property tax notice, TPPT is a hidden tax that never makes an appearance on any receipt, nor does every entrepreneur

understand, when they purchase a new item, the tax burden it will create for years to come. **Transparency** is important for taxpayers and voters to consider the merits of any tax, but the TPPT is invisible for the most part.

Real property and tangible property are not always taxed in the same manner. This can cause a business to alter its investment behavior.⁶ Also, the TPPT is collected once a year, which could cause some businesses to wait to purchase new equipment until after that date, or to get rid of equipment prematurely before that date. A **neutral** tax would not encourage such tax avoidance behavior that serves no practical purpose for businesses or their customers.

This annual tax on business supplies violates nearly every principle of fair tax policy and continues to persist as a thorn in the side of small businesses.

Although property taxes are considered to be one of the most reliable and **stable** sources of revenue for the government—because property ownership is rather consistent—this is usually reserved for real property; there does not seem to be any analysis available that shows the same can be said for tangible property.⁷

Repeal Efforts Elsewhere

Eight states have eliminated TPPT in its entirety, including “blue” states like Hawaii, Illinois, and New York. Four additional states tax hardly any tangible property, effectively eliminating the tax altogether.

From 2000 to 2009, 28 states (including Utah) decreased dependency on tangible property taxes, and only four states increased taxes on tangible property.⁸

In recent years, four states have attempted to reduce taxation on tangible property, with significant progress being made in Michigan, where a majority of TPPT will be eliminated by 2023,⁹ and Indiana, which implemented a per item de minimis exemption of \$20,000.¹⁰

Recent Changes in Utah

In 1969, inventory held for sale by a business was exempted from the TPPT, so that retail stores would not be taxed on items for which they were merely middlemen.

More recently, in 2007, Representative John Dougall was able to pass a de minimis exemption of \$3,500 in aggregate through the Utah Legislature via House Bill 26.¹¹ In 2012, Rep. Dougall was again able to add a \$1,000 per item exemption through House Bill 387.¹²

Senator Wayne Harper continued the momentum with Senate Bill 35 in 2013, by increasing the de minimis exemption from \$3,500 to \$10,000 while adding an inflationary index.¹³

An Antiquated Tax

Utah has prided itself on cultivating an excellent business climate. This

does not mean, however, that public policy has been perfected. Utah continues to tax tangible personal property. **This tax on business supplies violates nearly every principle of fair tax policy and continues to persist as a thorn in the side of small businesses.**

Small business owners should stop being forced to count and tally all of their equipment, and instead be allowed to flourish and grow. The revenue generated does not justify the enforcement costs to government or the wasted time and effort required by business owners to report and pay this inequitable tax.

Utah policy makers would be wise to decrease this heavy burden on Utah businesses—especially small and medium sized ones that employ most Utahns. The tangible personal property tax must be eliminated if the state is to continue down a path of equitable tax reform for all.



Endnotes

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8. Ibid.
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12. House Bill 387, 2012 Utah Legislature General Session, <https://le.utah.gov/~2012/bills/static/HB0387.html>.
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PROPOSAL A: ELIMINATE TPPT IN ITS ENTIRETY

The time has come for this nearly 170-year-old tax to end. On the East Coast, it harkens back to colonial times. When tax systems relied almost exclusively on property, taxing tangible property may have been appropriate. But now that tax systems include personal and corporate income, sales and use, and a number of other taxes, the minutiae of tangible property should be excluded as several states have now done.

Real property will continue to be taxed, and a very slight increase in real property taxes will offset the change and allow local government entities to be held harmless from a sharp reduction in tax revenues. This elimination would require a constitutional amendment, as follows:

Article XIII, Section 3.[Property tax exemptions.]

...

(2) (a) The Legislature may by statute exempt the following from property tax:

...

(vi) tangible personal property that, if subject to property tax, would generate an inconsequential amount of revenue.

The Legislature would then pass a companion bill that would statutorily eliminate the Tangible Personal Property Tax upon passage of the amendment to Utah's Constitution.

PROPOSAL B: EXEMPT ALL PERSONAL PROPERTY ON WHICH SALES TAX HAS ALREADY BEEN PAID

It could be argued that heavy machinery and other large equipment used for manufacturing are an important part of the local tax base for some jurisdictions, such as rural counties. This type of equipment, in most cases, has already been exempted from sales tax at the point of purchase. This could provide a firm line that could be drawn to exempt a large portion of tangible property without completely eliminating the tax. Therefore, we propose exempting all tangible personal property on which the owner is legally obligated to pay sales and use tax. This would save businesses around \$70 million a year.

PROPOSAL C: RAISE THE EXEMPTION THRESHOLDS

A smaller reform could be carried out by simply increasing exemption thresholds that have been established in the past. The current exemption threshold of \$10,000 for the total aggregate tangible property of a business could be increased to \$50,000. The current exemption threshold of \$1,000 for a single item of tangible property could be increased to \$2,500. Further, we would propose that exempt businesses be proactively excluded from the tax so owners do not have to file a report each year.

PUBLIC POLICY BRIEF

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FREQUENT
RECURRENCE
===== TO =====
FUNDAMENTAL
PRINCIPLES IS
ESSENTIAL
===== TO =====
THE SECURITY
===== OF =====
INDIVIDUAL
RIGHTS

UTAH CONSTITUTION
ARTICLE I, SEC 27