

POLICY *brief*

AN ANALYSIS OF THE ECONOMIC CONSEQUENCES OF MODIFYING THE PROPERTY TAX ON MOTOR VEHICLES IN GEORGIA: ALTERNATIVE PROPOSALS AND REVENUE EFFECTS

Introduction

Over the past year, there has been increased interest in Georgia and elsewhere in the idea of sharply reducing the property tax levied on motor vehicles. In 1998, legislatures in three states, Virginia, South Carolina, and California proposed bills which would, over time, eliminate or reduce the property tax on motor vehicles in those states.

In 1996, Georgian counties and municipalities collected \$474 million from property taxes levied on motor vehicles. Of the total motor vehicle property tax revenues in 1996, 28 percent went to county governments, 57 percent to school districts, 14 percent to cities and special districts, and 1 percent to the state.

Proposal Descriptions and Estimates

At this time three states, Virginia, South Carolina, and California, have proposed to reduce or eliminate the property tax on motor vehicles, each state taking a slightly different approach to the issue. Virginia has adopted legislation, and after the research for this paper was conducted, Governor Pete Wilson of California signed legislation that would reduce the motor vehicle property tax rate by 25 percent initially, and by 67 percent when fully implemented. Although the South Carolina proposal had strong support in both houses of the legislature, it was delayed prior to final passage; no vote was taken before

the close of the 1998 session. The California proposals considered are a proposal by Governor Wilson and a proposal introduced into the California State Assembly. For each of these four proposals, the revenue, distributional, and administrative implications for Georgia of adopting each proposal are considered. (More detail can be found in the full report from which this Policy Brief is drawn.)

Virginia Proposal

The Virginia approach eliminates the property tax on the first \$20,000 of market value of a personal-use motor vehicle, which includes all personal passenger cars, motorcycles, and pickup or panel trucks. The tax reduction is phased-in over a 5-year period. The state government is to reimburse local governments for the loss of revenue, but based on the 1997 millage rate.

If adopted in Georgia the proposal would, when fully phased-in, completely eliminate the tax on over 80 percent of the vehicles currently subject to tax. This percentage would decrease over time as more new vehicles exceed the \$20,000 ceiling. On average, each vehicle owner would receive a refund in 1999 of \$12 per vehicle, and \$79 per vehicle when the legislation is fully phased-in. This amount is dependent on each jurisdiction's actual millage rate and will vary widely across localities in Georgia.

South Carolina Proposal

The South Carolina proposal is designed to completely eliminate the property tax on all motor vehicles, personal and commercial. This proposal caps local government receipts from the property tax at their 1998 level. The proposal creates a property tax relief fund which is created by using annual state contributions of 30 percent of the increase in state revenue and is designed to reimburse localities for the loss in revenues stemming from the elimination of the property tax. If adopted in Georgia, this proposal would, when fully implemented, eliminate the tax on over 5 million personal and business use vehicles and result in an average tax savings of approximately \$100 per vehicle.

California Proposals

Instead of a motor vehicles property tax, California levies an in-lieu tax, also called a privilege tax, referred to as the Vehicle License Fee. Californians pay an amount equal to 2 percent of the value of the motor vehicle. The tax rate is levied at the state level and is applied to all vehicles. Two bills reduce or eliminate this tax on motor vehicles are considered, one developed in the California Assembly and one proposed by Governor Wilson. Similar to the other state bills, each of the California proposals include for some kind of reimbursements to the local governments.

Assembly Bill 1776. This proposal phases-out the Vehicle License Fee in a manner very similar to the Virginia plan. The plan, as drafted, would apply only to noncommercial vehicles. Under this bill, the market value of all noncommercial vehicles is reduced in \$5,000 increments until 2003, at which point the tax is completely eliminated. If adopted in Georgia, in 1999 the average tax savings per vehicle would be \$28, which would increase to \$81 when fully phased-in.

Governor Wilson's Plan. Governor Wilson has proposed a gradual reduction of this tax by cutting the state-wide tax rate from 2 percent to 1 percent in 1999 and to 0.5 percent in 2002. This tax reduction would apply to both personal and business use motor vehicles. His proposal also calls for an annual reimbursement to the localities for the loss in revenue. If adopted in Georgia, the average tax savings in 1999 per vehicle would be \$59, which would increase to \$96 when fully phased-in.

Table 1 shows the estimated magnitude of the cut in taxes for each of the four proposals if adopted in Georgia. Those plans that include commercial vehicles result in substantially greater loss in revenue. Placing a high cap on the value subject to the reduction (i.e., the Virginia proposal), results

in almost the same revenue loss as a proposal with no cap at all (i.e. AB 1776).

Table 2 shows the manner in which the tax cut would be distributed across income classes for the Virginia and Governor Wilson plans. The distributional analysis reveals a progressive tax cut, which is not surprising given that motor vehicle ownership is highly correlated to income. The distribution of the tax cut is essentially the same for each of the proposals other than Governor Wilson's. Under the Wilson plan the tax savings for each income class is less than that experienced under the other plans, but the tax saving is still progressive.

Administrative Issues

The administrative issues associated with these proposals will vary depending on the proposal adopted. Many of the issues discussed below are based on the experience of implementing the Virginia proposal.

One issue which all proposals must face has to do with the determination of eligibility for the proposals that limit the tax break to personal use vehicles. One option is to make the vehicle ineligible if a vehicle owner takes a Federal tax deduction for business use of the vehicle. Verifying this status could be done by requiring a copy of the Federal tax return or by random audits.

This issue becomes particularly problematic in the case of leased vehicles. The proposals require that the leasing companies notify the Department of Revenue as to which vehicles are used for personal use. This information is not currently collected and would place a great burden on the leasing company.

In Georgia not all the taxing jurisdictions have the same fiscal year for their budget process. This creates some difficulty in terms of reporting and reimbursements. These proposals require input from both the county treasurer and from the county tax commissioner, which in Virginia required establishing new lines of communication and cooperation.

The sheer number of taxing jurisdictions (well over 1,000) will cause a paperwork and tracking ordeal. The Virginia legislation includes some funds to bring electronic information transfer to the local taxing jurisdiction. This will aid the state in determining the appropriate level of reimbursement and also in their audit procedures. Furthermore, there currently exist several districts in Georgia that appraise property at values other than 40 percent, so adjustment will have to be made for that. Lastly, there is no unique district identifier used by all state and local departments in

Table 1. Revenue Effects of Alternative Motor Vehicle Legislation
(Calendar Years/ units in millions)

	1999	2000	2001	2002	2003	Total 99-03*
Virginia	-\$36	-\$74	-\$127	-\$185	-\$261	-\$682
South Carolina	-\$189	-\$362	-\$525	-\$547	-\$547	-\$2,169
CA. AB 1776	-\$86	-\$136	-\$172	-\$196	-\$264	-\$854
Governor Wilson	-\$297	-\$457	-\$469	-\$485	-\$502	-\$2,209

*Annual amounts may not sum to the total due to the effects of rounding.

Table 2. Distributional Effects of Virginia and California Proposals by AGI (Year 2003)

	Virginia Plan	Virginia Plan	Wilson Plan	Wilson Plan
Adjusted Gross Income	Tax Savings by Household	Tax Savings as a Percent of Mean AGE	Tax Savings by Household	Tax Savings as a Percent of Mean AGI
\$0 - \$10,000	\$52	1.86	\$39	1.38
\$10,000 - \$20,000	\$105	0.60	\$79	0.45
\$20,000 - \$30,000	\$132	0.47	\$99	0.35
\$30,000 - \$40,000	\$187	0.47	\$141	0.35
\$40,000 - \$50,000	\$216	0.42	\$164	0.32
\$50,000 - \$75,000	\$236	0.34	\$178	0.26
\$75,000 - \$100,000	\$280	0.28	\$210	0.21
\$100,000 and above	\$368	0.14	\$277	0.11

Georgia, which creates a confusing system of data collection and information exchange.

All of these issues are solvable but the state and local governments will likely require additional resources in the form of additional staff and computers to audit, track, collect and transfer the needed information to the state level.

Conclusions and Policy Recommendations

The following are conclusions and recommendations based on the analysis of the several proposals to eliminate or reduce the property tax on motor vehicles.

- All these proposals offer well constructed models for other states to follow. While in each case there exist some problems with implementation, these can be overcome with advanced preparation and greater information.
- The stated objective of this tax cut has always been a bit vague. The major criticism of this tax, as opposed to other taxes, is that it is due as a lump sum payment.

This can create a true financial burden for some households. This burden will be much greater, though, in states that base the tax on the full market value of the vehicle, such as California and Virginia.

- By requiring the state to reimburse the localities for the revenue loss associated with this exemption, the tax is simply shifted from the local level to the state level. In doing this, the tax becomes hidden from the taxpayers. The "exempted" motor vehicle value is not truly exempted but merely paid by the state taxpayers. But since state tax payments are due on a periodic basis or through payroll deduction, the obligation (i.e. the tax on motor vehicles shifted to the state taxpayers) is paid over time.
- A reduction in the tax will likely not result in an increase in motor vehicle consumption.
- Reducing or eliminating the tax will in the short run reduce the tax bill of state residents in a visible and straightforward manner by reducing or eliminating their annual property tax bill for motor vehicles. On the

other hand, the long run consequences of a reduction or elimination may be quite different.

- These proposals are unlikely to reduce local government spending. The elimination of the motor vehicle tax base means that increased expenditures will have to be financed from a smaller property tax base, or from other revenue sources. The same would be true if the state does not fully reimburse local government for the reduction in revenue. To the extent there is a shift from property taxes to a sales tax or fees, the result would be a reduction in Federal income tax deductions for individuals who itemize their taxes, thus increasing the tax burden of individuals who itemize deduction on their tax return.
- The long run consequences depend on the growth of state revenues. While these proposals decrease taxes at the local level, they increase spending at the state level due to their reimbursement requirements. In times of budget surpluses or high growth this new obligation may not seem burdensome. (By way of comparison, the recent state income tax cut was \$205 million.) Problems in fulfilling the obligation may arise, though, in times of decreased state tax revenues. During the initial phase-in period these proposals contain special provisions to limit the claims of the state reimbursements on the state budget in case of a decline in state revenues. With these provisions in place the state will only allow an exemption level which can be afforded by the current level of revenues.
- Once the proposal is fully phased-in it becomes less clear what happens to the state reimbursements in the event of a decline in state revenues. In the Virginia and South Carolina proposals some provisions are included to deal with this contingency, but none which would completely guarantee full reimbursement in the event of a decline in state revenues after the exemption has been fully phased-in.
- In addition to limiting the tax base of all localities, the modification to the property tax base will affect some localities more than others. If state reimbursements are tied to historical revenue collections, there is no accommodation made for future growth. In the Virginia proposal state reimbursements are based on the locality's millage rate in the initial year. While millage rates do rise and fall from year to year, over time these rates tend to follow an upward trend. Therefore, over the long run localities will likely face a decreasing reimbursement in real terms.

- Lastly, incursion of the state into the taxing domain of the localities is likely to meet with opposition from local public officials. Although localities are granted the privilege of taxation from the state, many local officials will see this effort to reduce the public's tax burden as an effort to erode the localities's power.

In conclusion, the merits of this tax are best judged when the proposal is considered in its true light. The real advantage of these motor vehicle proposals come from making the motor vehicle tax payable over time and redistributed over all state taxpayers. A true tax cut may occur only if neither state nor local governments increase their taxes due to this "exemption". The disadvantage of these proposals comes in the form of increased risk to the local governments that future reimbursements will be curtailed. In addition, because these reimbursements are tied to historical collections or previous millage rates, they erode the tax base under the control of the local governments.

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For a free copy of the study from which this Policy Brief is drawn, or any of the other publications listed, call the Fiscal Research Program at 404/651-4342, or fax us at 404/651-2737.

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