

## GOVERNOR RILEY'S TAX REFORM PACKAGE IS IMPROVED BY THE SENATE

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The most important measures of Governor Bob Riley's tax reform package have now survived the gauntlet known as the Alabama Legislative process, and in some areas the proposal is better now than when introduced. The Senate improved the package to generate much needed voter support while keeping the revenue streams intact.

### **A. Property Tax Survives The Land Baron and Big Business Assault.**

The property tax proposal escaped a bruising onslaught by several different special interests. Thanks to watchful shepherding by a number of visionary lawmakers in both the House and the Senate, the people of Alabama will finally have the opportunity to vote for this stable and adequate funding for our schools. The journey to referendum was a difficult one, though.

The property tax proposal will provide the most stable source of funding for Alabama's woefully underfunded schools. This proposal began with three main objectives:

update the valuation of land, set a true value on property for assessment purposes, and provide a mechanism through which our Revenue Department can stay up to date on property values. The final proposal will cover all of these objectives while phasing in the full tax burden on farmers and landowners.

Those special interests representing large agricultural and forest landowners made a fine showing for their groups throughout the legislative process. The current use valuation of land provisions that now exist enjoyed a nice log flume ride through the House and the Senate on their way to the voters with necessary reform being delayed a few years with grandfathering provisions. What went into the sausage maker as a immediate update of current use valuation for all land came out with some very distinct farm-friendly provisions.

Throughout the process, the Governor's proposal included a farmstead provision exempting 200 acres of land from all property taxes. This exemption was thought to be fair by all concerned, and the farmstead is a concept long advocated by this writer. This provision

was rightly modified to include 200 acres whether contiguous or non-contiguous. However, as feared in our last article, the exemption has expanded into a loophole allowing trusts, corporations, and other limited liability entities owning farms and land to claim it. Let us hope that we do not see the same flim flam tax avoidance shenanigans seen in corporate income tax. Hopefully, language added by a few vigilant Senators led by Hank Sanders will inoculate the ad valorem tax against unwelcomed tax avoidance schemes.

As you know, the present current use valuation survived the House through amendment, but the final version from the Senate and the Conference Committee provides a much more palatable phased in update of this valuation tool. First, landowners can claim a 2000 acre exemption that will value their land at present current use levels. The landowner owning over 2000 acres will have the new valuation for the rest of the land phased in over a few years until all acreage above the 2000 acre exemption is taxed at the new valuation.

To recap the property tax proposal as it will be before the voters in September, let's look over the mechanics:

Residential property values will increase through a phased in process until the property is appraised for assessment purposes at 100% of fair market value. To offset the sharp increase, the homestead exemption is raised to \$50,000 over time, and the state millage rate is lowered from 6.5 to 3.5.

Farm and timberland will be appraised using an updated and increased current use valuation formula for assessment purposes. To offset these increases, a number of fairness provisions have been incorporated. First, the small farmer or landowner will be able to claim a 200 acre farmstead exemption from any tax. Next, the landowner can elect to have the first 2000 acres of land appraised using the present current use system. Additionally, the landowner can elect to have a decreasing percentage of the remainder of the land appraised using the existing current use valuation. This will effectively phase in an updated version of

this state's current use valuation and bring us in line with our sister states and their treatment of large tracts of land. Timber and agricultural landowners will also be able to claim an exemption of \$150,000 of new value added to their property for use in their agricultural or timber industry, encouraging economic development.

Business and other utility property will now be assessed on an equal footing after a ten year phase in. Both of these categories will be assessed at 22%. This will be a reduction for the utility companies, but business will see a 10% increase in their assessment ratios. Of all categories of property taxpayers, these two can most easily pass this cost on to the consumer. Finally, we'll tax business property the same whether it produces guns or butter. Our most stable tax base will benefit significantly. So will our schoolchildren.

An interesting side note to the property tax measure that seems to have resolved itself is the attempt by large companies to use their net operating losses to reduce ad valorem tax. Such an unorthodox measure would not only improperly use an income tax deduction to

reduce property tax, but it would directly undermine the main strength of property tax: a guaranteed revenue stream independent of the economy.

This mixing of apples and oranges to create a business loophole was added in Senate Committee, but it does not seem to have survived the Conference Committee voyage. Such a regressive measure would have significantly eroded the argument for tax fairness that must sway the voters to support the package. Big business already enjoys innumerable tax breaks that the rest of us do not enjoy, and any further break would simply fly all over the hard working voters of this state.

The long and short of the property tax provisions now before the voters can be summed up in one word, stability. Over the years we have seen sources of revenue dry up and starve our schoolchildren. Consumer tastes need only change slightly for sales tax revenues to dip dramatically. Income tax revenue has been recently seen to undulate more

than the water level at a pool during a belly flop contest. A steady and reliable property tax will have to carry the day for our schoolchildren to enjoy the education they deserve.

**B. Senator Sanders Fine Tunes the Income Tax Bill.**

Speaking of income tax, the final measure produced by the Legislature provides long awaited fairness to a most regressive tax system. The Senate's final modifications to the income tax bill addresses fairness and, perhaps more importantly, will assist with public relations, not to mention giving retirees a reason to smile.

The Senate eased the income tax bill's burden on Alabama's retirees. An exemption on the first \$40,000 of income from a defined contribution retirement plan, such as a 401(K) or SEP Plan, was added. This wise move should give the package momentum, as the elderly historically make up a large percentage of voters who actually go to the polls. This may also keep a few retirees from moving to Tennessee or Florida where income is not taxed.

Governor Riley touted his tax package as being fair and equitable to businesses and individuals alike. He could not credibly explain why corporations were retaining 25% of their Federal income tax deduction while individuals lost the whole thing, however. Senator Sanders therefore advanced the tax fairness position for the Administration by taking away the remaining 25% of the deduction from corporations. This material improvement in the package will give individuals peace of mind in knowing that corporations will share the same burden.

The income tax bill survived many attacks from outside business interests throughout the Special Session. The Senate skewered business friendly amendments from the outset. Individuals should feel comfortable with our income tax changes. It's not perfect, but significant improvements were made.



**C. Tobacco Tax: Chewers and Smokers to Be Treated Alike.**

The Senate approved Governor Riley's proposal to increase sales tax on cigarettes but added a few improvements of its own. The bill now includes a tax increase on smokeless tobacco. Smokeless tobacco was left out at first due to its limited revenue impact, but this is a good change in the name of fairness. A more controversial change upsetting County Commissions was an amendment prohibiting Counties and Cities from increasing cigarette taxes in the future. Counties and Cities administer an additional tax on cigarettes that varies by jurisdiction. The Senate wanted to ensure that Alabama would tax cigarette and tobacco products below regional averages, and decided that a cap was needed for the total cigarette tax to remain below the regional average of 62 cents per pack.

**D. The Haves Escape: Wealth Tax Dropped.**

In efforts that will benefit the wealthy and perhaps the elderly, the tax on intangibles, such as stocks, bonds and CDs, died in the Senate. The bill was amended several times

before being voted down. Throughout the Special Session, Legislators agreed that the bill lacked fairness and may have negative economic consequences. In many instances, the intangible tax could be the third tax on the same income, with State and Federal income taxes already taking a bite, arguably discouraging individuals to invest. A package that will hinge on every vote may have picked up a few more supporters with the intangible tax being dropped.

The Administration apparently borrowed the intangibles tax idea from states like Florida or Tennessee, who do not have income tax. However, it would have been more just to tax such intangibles, in fairness to those who already pay such taxes on tangibles, like real property and machinery, that create income. Tax equity bowed to political expediency.

**E. Conclusion: It's Your Turn Now.**

Governor Riley's longest journey now begins. He will stump the State for your vote.

In September, you will decide whether his package is fair. You will vote for Alabama's future or you will vote to mire us in the past.

As Governor Riley said on the first day of the Special Session, this is one time when we need to forget whether we are Democrats or Republicans. This is our one chance, perhaps in a lifetime, to truly move Alabama forward.

With these reforms, Alabama will no longer be the laughing stock of the Nation, now taxing a family of four's income when they make a meager \$4,600, instead of taxing them when they make \$20,000 under the new package. We no longer will have the lowest property tax in the Country and we will no longer be as fertile a playground for corporate income tax cheats.

As Reinhold Neibuhr said, almost nothing great, however virtuous, can be done alone. Don't just vote for this package, go out and lobby for it.

At some point in everyone's life, we have all thought we could change the world. Here is that one chance. The consequences of these reforms, if passed, will probably not be comprehended in our lifetimes, but in all probability will close one chapter in Alabama's history and open another.