

# CERTIFIED MONEY

Dent, Baker & Company, LLP

**SPECIAL EDITION**

## **IMPORTANT INFORMATION:** ***STATE TAX PROPOSAL***

***Referendum September 9, 2003***



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Dent, Baker & Company, your source for tax solutions, wants to inform voters about the upcoming referendum taking place in September. Our agenda is to educate the public with this Special Edition Newsletter.

Governor Riley has asked for an increase in taxes of some \$1.2 billion, an amount representing an increase in total state revenues of about 20%. This increase will become permanently imbedded in the system, along with the automatic increases that are inherent in property, income and consumption taxes.

All of us at Dent, Baker & Company hope you benefit from the enclosed material written by our professionals explaining, in a non-political way, how this referendum, if passed, will impact taxpayers.

Please go to the polls September 9<sup>th</sup> and vote for your beliefs. This time at least the taxpayers get to decide!

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## INDIVIDUAL INCOME TAXES

Bill Bailey, CPA

- Individual income tax rates remain at 5% on incomes up to \$75,000 for single individuals (\$150,000 for married individuals filing jointly). Incomes above these amounts will see their rate rise from 5% to 6%. Larger exemptions have replaced the lower tax brackets that exist in the current system.
- 75% of the Federal income tax deduction would be allowed for the year 2003. This deduction would be entirely repealed beginning in 2004.
- Many itemized deductions would be eliminated. These include:
  - Social Security, Medicare and Self-employment tax
  - Real estate taxes
  - City and county occupational taxes
  - Personal property taxes on auto tags
  - Investment interest expense
  - Casualty and theft losses
  - Miscellaneous deductions, including employee business expenses, investment expenses, tax preparation fees, home office expenses, etc.
- Only four categories of itemized deductions would be allowed. These are:
  - Mortgage interest on qualified residence
  - Charitable contributions, equal to the amount deducted on the Federal return
  - Medical expenses, subject to the same percentage limitations as on the Federal return
  - Qualified adoption expenses
- For tax year 2004, the standard deduction (for taxpayers who do not itemize) would be raised to \$4,750 for single individuals and to \$7,950 for individuals filing jointly. Beginning in 2005, Alabama's standard deduction would be equal to the Federal amount.
- Beginning in 2004, personal and dependent exemptions would be equal to 70% of the Federal amount.

The following examples show how the proposed tax plan would likely affect individual taxes at different income levels. In each example, the taxpayers are a married couple with two dependent children and typical levels of deductions. Every taxpayer will be affected differently depending upon which deductions are lost.

- Taxpayers with \$16,350 in taxable income would pay no tax, and thus will see a reduction of 100%.
- Taxpayers with incomes under \$50,000 will pay somewhat less or about the same.
- Taxpayers with \$150,000 in taxable income will pay approximately 30% more tax.
- Taxpayers with \$250,000 in taxable income will pay approximately 50% more tax.
- Taxpayers with more than \$250,000 in taxable income will pay between 50% and 70% more tax, as income rises.



## Individual Income Taxes continued...



### **Analysis:**

The largest component of this bill is the loss of the federal income tax deduction. Alabama would join most other states in disallowing this deduction. Due to the graduated nature of federal income taxes, this lost deduction will cost higher income taxpayers proportionally much more than lower income taxpayers. This change, combined with larger exemptions, will make the Alabama income tax more graduated, up to about \$300,000. At that point and above, the tax becomes flat. Other lost deductions will produce a wide range of revenues from taxpayers affected by the lost deductions. One particularly interesting change is that the state is proposing to increase real estate ad valorem taxes while simultaneously eliminating them entirely as an income tax deduction.

### **Winners:**

- \* Taxpayers who do not itemize deductions with incomes below \$50,000.
- \* Generally, lower income taxpayers benefit.

### **Losers:**

- \* Taxpayers with incomes over \$75,000.

## ***CORPORATE INCOME TAXES***

- The Federal income tax deduction would be reduced to 75% of the Federal tax liability for the year 2003. This deduction would be entirely repealed beginning in 2004.
- The Alabama corporate tax rate would be reduced from 6.5% to 6%.

The following examples show how the proposed tax plan would affect corporate taxes at different income levels.

- A corporation with \$100,000 in taxable income will pay approximately 19% more tax.
- A corporation with \$250,000 in taxable income will pay approximately 36% more tax.
- Corporations with more than \$350,000 in taxable income will pay approximately 40% more tax.



### **Analysis:**

Unlike individuals, corporations' only loss is the loss of the federal income tax deduction. Moreover, corporations are receiving an actual rate decrease from 6.5% to 6.0%. While this rate will achieve parity with individual rates, corporations will see a smaller increase in their taxes than individuals earning similar amounts.

### **Winners:**

- \* None.

### **Losers:**

- \* All corporations who pay Alabama income tax.





Michelle Watts, CPA

## PROPERTY TAXES

### INDIVIDUALS:

- State property taxes would be imposed on 100% of the property's value.
- Prior to this proposed bill, state property taxes were imposed on only 10% of the value of residences, timberland and owner-occupied farms.
- State property tax rate would decrease from 6.5 mills to 3.5 mills (a mill is 0.1%).
- Local property tax rates would remain unchanged on homes, farms and timberland.
- Homestead exemption would increase from \$40,000 to \$50,000 over four years.
- First 200 acres of owner-occupied farms would be exempt from state property taxes.
- Current use valuation of land would be limited to 2,000 acres. This limit will not be fully phased in until 2006.



### **Explanation:**

Under the proposed tax plan, the state property tax rate would decrease from 6.5 mills to 3.5 mills. However, the tax would now be assessed on 100% of the property's value instead of 10% of the value, which is the current assessment rate for homes, timberland and owner-occupied farms. Also, the homestead exemption would increase from \$40,000 to \$50,000 over a four-year period. These changes would result in an increase of as much as 400% - 500% in the state property taxes paid by many taxpayers. Even though the proposed plan does not increase local property tax rates on residences, most taxpayers in Jefferson County will also see an increase in their local property taxes due to the recently released 2003 property assessments. This is unrelated to the current legislation. Referendums are set in a number of areas to increase local rates.

The following example shows how the proposed tax plan would affect a taxpayer in Mountain Brook who owned a home valued at \$250,000.

	Current	Proposed	Increase	% Increase	
Value of Home	250,000.00	250,000.00			<i>In this example, the state portion of the taxpayer's property tax is currently \$136.50. This amount would</i>
State Tax	136.50	700.00	563.50	413%	
Local Tax	1,942.50	1,942.50	-	-	
Total Tax	2,079.00	2,642.50	563.50	27%	

increase to \$700 under the proposed plan. Please remember this is only the state increase. As you can see in the example, the local portion of the property tax did not change. However, if you live in Jefferson County, or any other county which reassessed its real property this year, the local portion of your real estate taxes is also likely to increase.



# Property Taxes Continued...



## Analysis:

Except for homes valued under \$60,000, all homeowners will pay more. Those with homes valued above \$100,000 will pay significantly more. When coupled with raises being made in Jefferson County this year as a result of the regular revaluation process, the two years of 2003 & 2004 could involve total increases in homeowner property taxes of 40-50%. Local referendum rate increases, if any, would be additional. Large landowners will get to wait 3 more years for their reappraisals and increases.

### Winners:

- \* Taxpayers with homes valued between \$40,000 and \$60,000
- \* Landowners benefiting from so-called current use rates, which are not being eliminated for 3 years and retain large exclusions
- \* Small farms

### Losers:

- \* All homeowners with homes valued over \$60,000
- \* Taxpayers with owner-occupied farms over 200 acres and timberland
- \* Taxpayers with over 2,000 acres will lose the benefit of current use valuation eventually

## BUSINESSES:

- State property taxes would be imposed on 100% of the property's value.
- Prior to this proposed bill, state property taxes were imposed on 20% of the value of most corporate property and 30% of the value of property owned by utilities.
- State property tax rate would decrease from 6.5 mills to 3.5 mills.
- Local property tax rates would increase from 20% to 22% on all commercial and business property – real property and personal property.
- Local property tax assessment rates for utilities would decrease from 30% to 22% over several years.



## Explanation:

Unlike residential property, business property will see an increase in both local and state taxes under the proposed plan. The changes in the state portion of the tax are similar to the changes for residential property. However, business property will see a 10% increase in the value subject to local tax, from 20% of the total assessed value to 22% of the same value.

The following example shows how property taxes will change on commercial property valued at \$250,000. This example assumes the property is located in Mountain Brook and has a total millage rate of 9.90%.

	Current	Proposed	Increase	% Increase
Value of Property	250,000.00	250,000.00		
State Tax	325.00	875.00	550.00	169%
Local Tax	4,625.00	5,087.50	462.50	10%
Total Tax	4,950.00	5,962.50	1,012.50	20%

*This example shows that the state taxes on \$250,000 of business property are currently \$325 and would increase by \$550 to \$875 under the proposed plan. The local taxes would increase by \$462.50, or 10%, to \$5,087.50. Therefore, the total increase in property taxes on*

*\$250,000 of business property in Mountain Brook would amount to \$1,012.50. Business property is also subject to reappraisal as are individuals.*



## Property Taxes Continued...

Under the new proposal, utilities would not immediately see any increase in the property taxes they pay. Their property taxes would be frozen at their 2001 amount. The assessment ratio for utilities would decrease from 30% to 22%, phased in over several years. In effect, utilities will pay the same tax as they did in the tax year 2001. This tax will remain the same until the value of their property increases enough to make their assessment ratio equal to 22%, but no later than 2011.



### **Analysis:**

Business properties are being increased an additional 10% on the local government portion of ad valorem taxes. This increase will go to the cities, counties and school districts, along with statewide increases applicable to all taxpayers.

Utility properties were previously assessed at higher rates than other businesses. That will change as their rate goes down and other businesses go up. Freezing the utilities property taxes at 2001 levels will allow them to avoid the reappraisal increases that others are facing, and avoid tax on any new investments until these investments 'catch up' with the new lowered rates. The local governments thus will not have to give back the 10% increase to utilities from other businesses. They just will not get an increase from utilities until 2011.

### **Winners:**

\* **Utilities, whose local tax assessment rate is being reduced from 30% to 22%.**

### **Losers:**

\* **All non-utility business taxpayers with real or personal property, due to the increase in state and local property taxes.**

## ***SALES TAXES***

- Impose a new 4% tax on installation and repair services
- Increase tax on motor vehicles and motorboat sales from 2% to 2.5%
- Double state sales tax on vehicle rentals from 1.5% to 3%
- Impose a 4% state sales tax on motor oil



### **Explanation:**

The proposed tax bill would affect taxpayers on many of their daily expenditures. A four-percent tax would be imposed on installation and repairs of tangible personal property. This means that a \$100 repair charge for your personal air conditioner would now cost \$104.

Taxpayers will also be affected when purchasing or leasing an automobile. Sales taxes on vehicle and boat sales would increase by 0.5%, from 2.0% to 2.5%, and state sales tax on leased vehicles will double from 1.5% to 3.0%. Therefore, state sales tax on a \$30,000 auto would increase by \$150, from \$600 to \$750. In addition, a 4% tax would be imposed on motor oil sales, thereby increasing the cost of maintaining your vehicle.





**Analysis:**

Leasing vehicles will lose some ground when compared to purchasing a vehicle, as leasing taxes are increasing by a much greater rate than buying. It likely will not change a lease/buy decision, but it will be a factor. Leasing will become relatively less appealing.

**Winners:**

\* Consumers avoiding these narrow areas of increases will be unaffected.

**Losers:**

\* Taxpayers purchasing those items.

## **MISCELLANEOUS PROVISIONS:**

- Increase cigarette tax from 16.5 cents to 31 cents per pack
- Double the deed and mortgage recording taxes
- Lower the maximum bank privilege tax from \$3 million to \$15,000
- Maintain maximum privilege tax of \$15,000

The governor's proposed bill also contains many miscellaneous provisions, including changes in cigarette taxes, deed and mortgage recording taxes, and bank privilege taxes. First, the tax on a pack of cigarettes is increased by 14.5 cents, from 16.5 cents to 31 cents per pack. Second, deed recording and mortgage recording taxes will be doubled for deeds and mortgages filed after October 1, 2003. Third, the maximum amount of privilege tax paid by banks will be lowered from \$3 million to \$15,000, which is the maximum amount paid by most other companies.



**Analysis:**

These miscellaneous provisions are a relative hodge podge of taxes that misses the mark of increasing taxes only on the wealthy. In particular, the business 'privilege' tax levied on asset values of corporations, LLC's, LLP's, and the like, ceases functioning once the tax reaches \$15,000. Thus, businesses that have hundreds of thousands more assets pay the same tax. Banks, which were singled out for a separate maximum of \$3,000,000 in tax, have successfully had this amount lowered to the same \$15,000. Businesses paying \$14,999 must be satisfied that the largest companies in the state pay only \$15,000.

**Winners:**

\* Banks.

\* Bigger businesses maintained a maximum amount of privilege taxes, thus being taxed at a lower rate than smaller businesses.

**Losers:**

\* Taxpayers buying and financing real estate will pay higher closing costs.

\* Smokers.



# Any Questions?



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We encourage you to ask us any questions or supply us with any feedback you may have about the firm or the services we offer so that we may better serve you.

*Please contact us with your questions or comments:*

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