



## Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

May 12, 2011

Joint Committee on Finance

Paper #605

### **Homestead Tax Credit -- Current Law Reestimate and Repeal Indexing of Formula Factors (Shared Revenue and Tax Relief -- Property Tax Credits)**

[LFB 2011-13 Budget Summary: Page 400, #1 and #2]

#### **CURRENT LAW**

The homestead tax credit program directs property tax relief to low-income homeowners and renters. Credits are limited to Wisconsin residents 18 years of age or older. The amount of the credit received by claimants depends on the interaction of household income (less a \$500 per dependent deduction) and allowable property taxes or rent under the three primary homestead tax credit formula factors: the income threshold; the maximum income level; and the maximum property taxes or rent constituting property taxes.

Under 2009 Act 28, beginning with tax year 2010, the three formula factors are indexed annually by the Department of Revenue (DOR), by comparing the 12-month average of the Consumer Price Index from August through July of the prior year to the comparable average from August, 2007, through July, 2008. For tax year 2011, the income threshold will be \$8,160, the maximum income level will be \$24,990, and the maximum property taxes or rent constituting property taxes will be \$1,480.

Claimants with income below \$8,160 receive a credit equal to 80% of allowable property taxes or rent. The 2011 credit will be phased out for claimants with income between \$8,160 and \$24,990, at which point the credit equals zero. For claimants with less than \$1,480 in allowable property taxes or rent, the credit will be eliminated at lower income levels. The 2011 credit formula can be expressed as a mathematical equation for individuals with income between \$8,160 and \$24,990 as shown below:

$$\text{Homestead Credit} = 80\% \times [\text{Property Taxes} - 8.794\% \times (\text{Household Income} - \$8,160)]$$

## GOVERNOR

*Current Law Reestimate.* Increase the estimated cost of the current law credit by \$7,400,000 GPR in 2011-12 and \$12,500,000 GPR in 2012-13. With these adjustments, estimated total funding for the current law credit would increase from an adjusted base level of \$127,000,000 to \$134,400,000 in 2011-12 and \$139,500,000 in 2012-13.

*Repeal of Annual Indexing of the Credit Formula Factors.* Decrease the estimated cost of the homestead tax credit by \$2,000,000 GPR in 2011-12 and \$6,100,000 GPR in 2012-13 associated with repealing the annual indexing of the credit's formula factors, beginning with tax year 2011. The factors would remain at the 2010 tax year amounts of \$8,060 for the income threshold, \$24,680 for the maximum income level, and \$1,460 for the maximum property taxes or rent constituting property taxes, with the reduction to eligible property taxes or rent constituting property taxes set at 8.785% of household income above \$8,060. Estimate the cost of the credit, as modified, at \$132,400,000 in 2011-12 and \$133,400,000 in 2012-13.

## DISCUSSION POINTS

### Reestimate of the Credit Under Current Law and the Bill

1. Table 1 compares the cost of the homestead tax credit under the Governor's recommendations and under a Legislative Fiscal Bureau (LFB) reestimate for both the current law credit and the proposed repeal of the annual indexing of the credit's formula factors. This office's reestimates reflect changes in the forecasted income of claimants, as well as the impact that the level of state aid to local governments and the local property tax levy limits under the bill would have on property taxes and on the cost of the credit. In addition, the LFB current law reestimate of the credit reflects an updated estimate of the tax year 2012 indexed formula factors, using IHS Global Insight Inc.'s April, 2011, forecast for inflation over the indexing period (August, 2010, through July, 2011).

**TABLE 1**

### Estimates of Homestead Tax Credit Under Current Law and Repeal of Annual Indexing

	Governor		LFB Reestimate		Change To Bill	
	<u>2011-12</u>	<u>2012-13</u>	<u>2011-12</u>	<u>2012-13</u>	<u>2011-12</u>	<u>2012-13</u>
Current Law Credit	\$134,400,000	\$139,500,000	\$133,800,000	\$139,700,000	-\$600,000	\$200,000
With Indexing Repeal	132,400,000	133,400,000	130,700,000	129,200,000	-1,700,000	-4,200,000
Change to Current Law	-\$2,000,000	-\$6,100,000	-\$3,100,000	-\$10,500,000	-\$1,100,000	-\$4,400,000

## **Indexing of the Homestead Tax Credit**

2. The homestead tax credit is designed to assist low- and moderate-income individuals and families with their property taxes. For 2009, the statewide average credit was \$520, which on average covered 31.1% of claimants' property taxes in that year. According to DOR's aggregate tax data for tax year 2009, there were 142,965 claimants with household incomes below \$15,000 (57.9% of all claimants), who received \$96.2 million in tax credits (74.9% of the total) in that year. DOR also indicates that in 2009 households receiving the credit had 101,019 dependents. There were 76,163 homestead tax credit claimants over age 65 (30.8% of all claimants), who received \$33.9 million in tax credits (26.4% of the total) in 2009.

3. The homestead tax credit program targets property tax relief to low-income households through an income-based formula. The relief is provided whether the taxpayer pays their property taxes directly as a homeowner or through rent. The program attempts to address the excessive property tax "burden" on an individual household. It is often referred to as a "circuit breaker" program since it is intended to provide property tax relief once those taxes exceed a taxpayer's ability to pay them. Under the credit formula, as a claimant's income rises, the amount of the claimant's property taxes or rent that is eligible for relief is reduced. Other state property tax relief programs that are paid directly or indirectly to municipalities cannot achieve such income-based targeting.

4. Indexing the homestead tax credit allows the credit to keep up with inflation so that claimants' credits do not erode as income levels increase over time. During most years of the program's history, growth in household income compared to constant formula factors generally has resulted in lower and fewer homestead tax credits being claimed. In other words, the value of each formula factor becomes smaller each year in real terms, leaving fewer individuals eligible for the credit. Prior to Act 28, the homestead tax credit formula was last changed under 1999 Act 9, which increased the maximum income level for claims under the credit from \$19,154 to \$20,290 for tax year 1999 and to \$24,500 for tax year 2000 and thereafter. If each formula factor had been increased annually since 2000 at the same rate as inflation, the 2011 formula factors would be \$10,520 for the income threshold, \$32,240 for the maximum income level, and \$1,910 for the maximum property tax or rent constituting property tax. The maximum credit would have increased to \$1,528.

5. Under 2009 Act 28, beginning with tax year 2010, the three formula factors are indexed annually by comparing the 12-month average of the Consumer Price Index from August through July of the prior year to the comparable average from August, 2007, through July, 2008. Table 2 lists the actual homestead tax credit formula factors for 2009 and 2010 and those factors that would exist if indexing would continue for each year of the biennium.

**TABLE 2**

**Homestead Formula Factors  
Under Current Law Annual Indexing**

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012*</u>
Maximum Income	\$24,500	24,680	\$24,990	\$25,450
Maximum Property Taxes	1,450	1,460	1,480	1,510
Property Tax Reimbursement Rate	80%	80%	80%	80%
Income Threshold	8,000	8,060	8,160	8,310
Rate that Income Reduces				
Eligible Property Taxes/Rent	8.788%	8.785%	8.794%	8.810%
Maximum Credit	1,160	1168	1,184	1,208

\* Estimated.

6. Under indexing, increasing the maximum household income level at which one may receive a homestead credit allows tax filers between the existing maximum income level and the new maximum income level to become eligible for a relatively small homestead tax credit. Those with incomes under the income threshold (\$8,060 for 2010) would only receive an increase in their credit if their property taxes or rent constituting property taxes are above the maximum level (\$1,460 for 2010). Those claimants with household incomes between the existing income threshold and the maximum income level would also receive increased credits, with the higher increases going to those with property taxes or rent constituting property taxes above \$1,460.

7. If the homestead tax credit was indexed for 2011, the size of the credit increase would range from \$7 for those claimants with incomes above the new income threshold and property taxes or rent constituting property taxes below the maximum amount (\$1,460 for 2010) to \$23 for those over that \$1,460 amount. For 2012, the corresponding increases would range from an estimated \$17 to \$57. Any claimant with a household income level below the current \$8,060 income threshold, and with eligible property taxes or rent under the \$1,460 maximum amount, would not receive an increase in their credit.

8. Several provisions of the state and federal tax laws are indexed annually to inflation in a fashion that is similar to the state's homestead tax credit indexing provisions. Table 3 lists some of these indexed provisions.

**TABLE 3**

**Examples of Existing State and Federal  
Tax Law Indexing Provisions**

<b>Provision</b>	<b>Indexed Factor</b>
<u>State</u>	
Standard Deduction	Deduction Amount
Income Tax Brackets	Income Bracket Levels & Phase-Out
Earned Income Tax Credit	Formula Factors
Homestead Tax Credit	Main Formula Factors
<u>Federal</u>	
Personal and Dependent Deduction	Deduction Amount
Standard Deduction	Deduction Amount
Income Tax Brackets	Income Bracket Levels
Earned Income Tax Credit	Maximum Credit Amount & Income Eligibility
Health Savings Accounts	Contribution Limits
Lifetime Learning Credit	Income Level for Claimants

9. Since the 2011 tax year has already begun, rather than repealing the expected indexing of the homestead tax credit formula factors for 2011, the Committee could make the repeal of indexing effective beginning in tax year 2012. This would allow one additional year of indexing, which would affect the size of individual credits in tax year 2011, and thereafter. Under this alternative, the cost of the credit would increase by \$1,400,000 in 2011-12 and decrease by \$1,100,000 compared to the bill. Compared to the reestimated cost of the credit with indexing repealed for both years, this alternative would increase the cost of the credit by \$3,100,000 annually [Alternative 2].

10. Administration officials indicate that the primary reason for repealing indexing was to limit the growth in the cost of the credit. In addition, they indicate that under the proposed limits on local property tax levies included in the Governor's budget recommendation, property tax levies would be held relatively flat, which would lessen the need for indexing [In an April 15, 2011, memorandum to all legislative members, the LFB estimated that the tax bills on a median valued home would increase over the prior year by 0.8% in 2011(12) and 0.4% in 2012(13) under the Governor's recommendations.] [Alternative 1].

**ALTERNATIVES**

1. Approve the Governor's recommendation to repeal the annual indexing of the homestead tax credit's formula factors, beginning with tax year 2011. In addition, decrease funding for the credit by \$1,700,000 GPR in 2011-12 and \$4,200,000 GPR in 2012-13 compared to the bill

to reflect a reestimate of the cost of the credit under the provisions of the bill. The homestead credit would total \$130,700,000 GPR in 2011-12 and \$129,200,000 GPR in 2012-13 under this action and reestimate.

<b>ALT 1</b>	<b>Change to Bill Funding</b>
GPR	- \$5,900,000

2. Delay the Governor's recommendation to repeal the annual indexing of the homestead tax credit's formula factors until tax year 2012 (the repeal of indexing would be delayed one year and the credit would be indexed for tax year 2011). In addition, increase funding for the credit by \$1,400,000 GPR in 2011-12 and decrease funding by \$1,100,000 GPR in 2012-13 compared to the bill to reflect both a reestimate of the cost of the existing credit and the one-year delay in the repeal of indexing. The homestead credit would total \$133,800,000 GPR in 2011-12 and \$132,300,000 GPR in 2012-13 under this action and reestimate.

<b>ALT 2</b>	<b>Change to Bill Funding</b>
GPR	\$300,000

3. Delete the Governor's recommendation to repeal the annual indexing of the homestead tax credit's formula factors. In addition, increase funding for the credit by \$1,400,000 GPR in 2011-12 and \$6,300,000 GPR in 2012-13 compared to the bill to reflect both a reestimate of the cost of the existing credit and the impact of retaining indexing. The homestead credit would total \$133,800,000 GPR in 2011-12 and \$139,700,000 GPR in 2012-13 under this action and reestimate.

<b>ALT 3</b>	<b>Change to Bill Funding</b>
GPR	\$7,700,000

Prepared by: Al Runde