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Joint Committee on Finance

Paper #573

Homestead Tax Credit -- Indexing of Credit for Claimants 62 or Older or Disabled (Shared Revenue and Tax Relief -- Property Tax Credits)

[LFB 2017-19 Budget Summary: Page 415, #6]

CURRENT LAW

The homestead tax credit is an income tax credit based on a formula that takes into account a tax filer's household income and property tax or rent paid during a tax year. To qualify for the credit, a claimant must be at least 18 years or older, must own or rent his or her residence, and must have household income under the maximum income level of \$24,680, regardless of whether it is earned income or not. Claimants do not need to have a tax liability or income (household income or earned income) in order to receive the credit. For purposes of calculating the credit, household income is adjusted downward by \$500 for each dependent to account for family size.

For claimants with income of \$8,060 or less, a credit is equal to 80% of property taxes or rent constituting property taxes up to a maximum of \$1,460 in property taxes or rent. Rent constituting property taxes is 25% of rent if payment for heat is not included in rent and 20% of rent if payment for heat is included. The maximum credit is \$1,168.

The credit is phased out for claimants with income between \$8,060 and \$24,680, at which point the credit equals zero. For claimants with less than \$1,460 in allowable rent or property taxes, the credit is reduced at lower income levels. The credit formula can be expressed as a mathematical equation for individuals with income between \$8,060 and \$24,680 as shown below:

$$\text{Homestead Credit} = 80\% \times [\text{Property Taxes} - 8.785\% \times (\text{Household Income} - \$8,060)]$$

In 2015-16, homestead tax credit claims totaled \$98,405,320.

GOVERNOR

Beginning with tax year 2018, annually index the following current law homestead tax credit formula factors for claimants 62 or older, whose spouse is 62 or older, or those who are disabled: (a) the maximum household income amount from the current level of \$24,680; and (b) the maximum income threshold amount from the current level of \$8,060. Increase the estimated cost of the credit by \$2,500,000 in 2018-19. The homestead credit formula factors would not be indexed for those with earned income who are under 62 and not disabled and who receive a credit under a modified formula (see LFB Paper #572).

The two formula factors would be indexed each year by the percentage change between the 12-month average of the Consumer Price Index (CPI), as determined by the federal Department of Labor, for all urban consumers, U.S. city average, for the months of August through July, of the prior year, over the same 12-month average of the CPI for August, 2015, through July, 2016. Allow that the adjustments would only occur if the percentage change in the CPI is a positive number.

Specify that the revised maximum household income and income threshold amounts would be rounded to the nearest multiple of \$10, or if the revised amount is a multiple of \$5, the amount would be increased to the next higher multiple of \$10. The Department of Revenue (DOR) would be required to annually adjust the slope (or rate) at which eligible property taxes are reduced for incomes above the income threshold so that the credit equals zero at the new maximum income amount. DOR would also be required to annually incorporate the changes into the state income tax forms and instructions.

DISCUSSION POINTS

Background

1. The current law homestead tax credit adjusted base is \$101.2 million. The reestimated cost of the current law credit is \$96 million in 2016-17, \$95 million in 2017-18, and \$94.5 million in 2018-19. The \$2.5 million fiscal effect of the Governor's proposal was based on the \$101.2 million adjusted base. However, due to the reduction in the overall size of the current law credit, the fiscal effect of the Governor's recommendation to index the credit for certain claimants is reestimated downward by \$200,000 in 2018-19 compared to the bill.

2. The homestead credit program directs property tax relief to low-income homeowners and renters. The program is often referred to as a "circuit breaker" program since it is intended to provide relief once property taxes exceed a taxpayer's ability to pay them. Relief is provided as a credit reducing individual income tax liability or as a cash refund if the credit exceeds income tax due. According to Department of Revenue aggregate data, credits of \$98.4 million were paid to approximately 191,500 households for tax year 2015.

3. Under 2009 Act 28, beginning with tax year 2010, the three formula factors were to be indexed annually by comparing the 12-month average of the CPI from August through July of

the prior year to the comparable average from August, 2007, through July, 2008. The three formula factors were indexed for tax year 2010. However, 2011 Act 32 repealed the annual indexing of the formula factors beginning with tax year 2011. Therefore, tax year 2010 was the only year in which indexing of the credit's formula factors occurred.

4. As shown in the following table, the count of claimants and amount of credits distributed under the homestead credit program have fluctuated, but generally declined over the past 10 years. From 2008 through 2011, total credit expenditures rose each year as a result of the recession during that period and indexing of the credit's formula factors in 2010. In recent years, credit expenditures have declined. This reduction is likely attributable to a recovering economy, increases in Wisconsin household income, and a stable or declining property tax level.

TABLE 1

Homestead Tax Credit Participation and Formula Factors by Tax Year

<u>Tax Year</u>	<u>Count</u>	<u>% Change</u>	<u>Amount (Millions)</u>	<u>% Change</u>	<u>Average Credit</u>	<u>% Change</u>	<u>Maximum Income*</u>	<u>Maximum Property Taxes</u>	<u>Income Threshold</u>
2006	233,070		\$119.4		\$512		\$24,500	\$1,450	\$8,000
2007	236,193	1.3%	122.0	2.2%	517	1.0%	24,500	1,450	8,000
2008	231,124	-2.1	121.4	-0.5	525	1.5	24,500	1,450	8,000
2009	247,011	6.9	128.5	5.8	520	-1.0	24,500	1,450	8,000
2010	250,845	1.6	132.9	3.4	530	1.9	24,680	1,460	8,060
2011	248,014	-1.1	133.0	0.0	536	1.1	24,680	1,460	8,060
2012	232,680	-6.2	121.8	-8.4	523	-2.4	24,680	1,460	8,060
2013	222,942	-4.2	117.0	-3.9	525	0.4	24,680	1,460	8,060
2014	202,687	-9.1	105.3	-10.0	520	-1.0	24,680	1,460	8,060
2015	191,459	-5.5	98.4	-6.6	514	-1.2	24,680	1,460	8,060

*Household income was reduced by \$250 for each dependent through tax year 2009 and by \$500 for each dependent beginning in tax year 2010.

5. The net impact on a claimant's credit depends on an interaction of changes in the claimants' income and property taxes or rent. Assuming no changes in formula factors, homestead credit participation and credit claimants tend to change over time in three major ways: (a) rising income will cause some claimants to exceed the maximum income level of (\$24,680); (b) other claimants' incomes rise above the income threshold (\$8,060); and (c) rising property taxes or rents will only increase credits until the tax bill or rent exceeds the maximum property taxes or rent (\$1,460). As a result, if no changes are made to the formula factors, the number of eligible claimants tends to decrease over time.

Governor's Proposal

6. The Governor's proposal would annually index the two of the three homestead credit formula factors for claimants 62 or older, whose spouse is 62 or older, or who are disabled: (a)

the maximum household income amount from the current level of \$24,680; and (b) the maximum income threshold amount from the current level of \$8,060. The proposed method for indexing the maximum income level and income threshold would be similar to how the credit was indexed in 2010 and to the way DOR annually indexes the state's income tax brackets and standard deduction. Table 2 shows the projected formula factors from indexing under the Governor's proposal for tax year 2018 through 2020 based on current inflation projections.

TABLE 2

Homestead Tax Credit Formula Factors Under the Governor's Proposed Indexing

	<u>Current Law</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
Maximum Income	\$24,680	\$25,260	\$25,790	\$26,430
Income Threshold	8,060	8,250	8,420	8,630
Reduction Rate	8.785%	8.583%	8.405%	8.202%
Maximum Property Taxes	1,460	1,460	1,460	1,460
Maximum Credit	1,168	1,168	1,168	1,168

7. Based on the provisions in the bill, the proposed formula changes would first affect the cost of the homestead tax credit in 2018-19. Raising the maximum household income level at which one may receive a homestead credit would allow tax filers between the existing maximum income level (\$24,680) and the new maximum income level to become eligible for the credit. It would also lower the rate at which eligible property taxes are reduced above the indexed income threshold and those between the existing income threshold (\$8,060) and the indexed threshold would no longer see their credit erode as income rises. As a result, most of the cost associated with increasing the maximum income level would be due to the larger credits that would be provided to existing claimants with household incomes above the \$8,060 income threshold.

8. Using 2014 aggregate statistics, indexing as proposed under AB 64/SB 30 would affect approximately 94,000 claimants, of which approximately 64,000 (68.1%) are 62 or older and approximately 30,000 (31.9%) are disabled. For these individuals, credits are estimated to increase by an average of \$24 in 2019 due to indexing.

9. The Governor's Budget in Brief indicates that indexing the two homestead credit formula factors for claimants aged 62 or older and for those who are disabled is intended to ensure that the credit's value is not eroded by inflation for those on fixed incomes. Many contend that the credit factors should be indexed each year to the annual change in CPI because constant formula factors tend to reduce the number of eligible claimants and erode the size of the remaining claimants' credits.

Alternatives to the Governor's Proposal

10. The Committee's decision on the Governor's proposed modifications to the homestead tax credit (see LFB Paper #572) will impact the decisions that would be available to the

Committee relating to the indexing of the credit factors. Each of the alternatives discussed in this section could be adopted, but which one remains a viable alternative would depend on the Committee's actions on the Governor's proposed modifications to the credit.

11. The Governor's proposal would not index the credit for those with earned income, who would be eligible for a modified homestead tax credit under the Governor's proposed modifications to the credit (see LFB Paper #572).

12. If the Committee adopts the Governor's proposed credit modifications, some could contend that indexing should also occur for those claimants with earned income, who would be eligible for a modified credit under the bill, and not just for those 62 or older or disabled. Given the earned income requirements, these claimants would be required to be participants in the labor force and may receive wage increases over time. However, without indexing the credit for such claimants, the current trend of declining credits will continue for this group of claimants in future years.

13. Similarly, if the Committee retains the current law credit for existing claimants by deleting the Governor's proposed modifications to the credit, the Committee could still consider indexing the existing credit. Similar to the Governor's reasoning for the indexing the credit for those 62 or older or disabled, indexing the credit for all existing claimants would ensure that credit would not erode for those with no or limited earned income.

14. Also, the Governor does not propose indexing one of the three formula factors: the maximum property tax. Indexing this factor would result in an increase in the maximum credit from \$1,168 to \$1,195 in tax year 2018 and \$1,220 in tax year 2019. Indexing just the two formula factors as proposed by the Governor would not have an effect on the credit for claimants with household income below the current income threshold (\$8,060). However, indexing the maximum property tax level would increase the credits of eligible claimants of all household income levels, including those with household income below \$8,060, with property taxes or rent constituting property taxes that exceed the current limit (\$1,460). Compared to the Governor's proposal, this would target some tax relief to those with the lowest household incomes.

15. The following alternatives could be considered if the Committee **approves** the Governor's proposed modifications to the homestead tax credit described in LFB Paper #572.

- Index two formula factors (maximum income and income threshold) as proposed by the Governor for: 1) claimants aged 62 or older, whose spouse is 62 or older, or who are disabled [Alternative A1a]; or 2) all claimants eligible for the Governor's modified credit [Alternative A1b].

- Index all three formula factors for: 1) claimants aged 62 or older, whose spouse is 62 or older, or who are disabled [Alternative A2a]; or 2) all claimants eligible for the Governor's modified formula [Alternative A2b].

16. The following alternatives could be considered if the Committee **deletes** the Governor's proposed modifications to the homestead credit described in LFB Paper #572.

- Index the Governor's proposed formula factors (maximum income and income threshold) for: (a) claimants aged 62 or older, whose spouse is 62 or older, who are disabled, or have earned income [Alternative B1a]; or (b) all claimants eligible under current law [Alternative B1b].

- Index all three formula factors for: (a) claimants aged 62 or older, whose spouse is 62 or older, who are disabled, or who have earned income [Alternative B2a]; or (b) all claimants eligible under current law [Alternative B2b].

17. The following table indicates the fiscal effect in 2018-19 of each of these alternatives compared to the Governor's indexing recommendations as reestimated.

TABLE 6

Fiscal Effect of Proposed Alternatives Compared to the Bill Reestimated

<u>Claimants</u>	<u>2018-19 Expenditures</u>	
	<u>Governor's Modifications</u>	<u>Current Law Formula</u>
Index Two Income Formula Factors		
Age 62+, disabled, and those with earned income	\$1,100,000	\$1,300,000
All claimants (current law claimants)	N.A.	1,500,000
Index All Three Formula Factors		
Age 62+, disabled	\$300,000	N.A.
Age 62+, disabled, and those with earned income	1,600,000	\$1,800,000
All claimants (current law claimants)	N.A.	2,100,000

ALTERNATIVES

A. Governor's Credit Modifications Approved

1. Approve the Governor's recommendation to index the maximum income level and income threshold formula factors by the percentage change between the 12-month average of the CPI for the months of August through July, of the prior year, over the same 12-month average of the CPI for August, 2015, through July, 2016, rounded to the nearest \$10, as follows:

a. As recommended by the Governor, index the credit for claimants 62 or older, whose spouse is 62 or older, or who are disabled. Decrease the estimated cost of the credit by \$200,000 in 2018-19 to reflect the reestimate of the Governor's recommendation.

ALT A1a	Change to	
	Base	Bill
GPR	\$2,300,000	- \$200,000

b. Index the credit for claimants aged 62 or older, whose spouse is 62 or older, who are disabled, or have earned income. Increase the cost of the credit by \$1,100,000 in 2018-19 compared to the bill.

ALT A1b	Change to	
	Base	Bill
GPR	\$3,400,000	\$1,100,000

2. Modify the Governor's recommendation and index all three formula factors by the percentage change between the 12-month average of the CPI for the months of August through July, of the prior year, over the same 12-month average of the CPI for August, 2015, through July, 2016, rounded to the nearest \$10, as follows:

a. Index the credit for claimants aged 62 or older, whose spouse is 62 or older, or who are disabled. Increase the cost of the credit by \$300,000 in 2018-19 compared to the bill.

ALT A2a	Change to	
	Base	Bill
GPR	\$2,600,000	\$300,000

b. Index the credit for claimants aged 62 or older, whose spouse is 62 or older, who are disabled, or who have earned income. Increase the cost of the credit by \$1,600,000 in 2018-19 compared to the bill.

ALT A2b	Change to	
	Base	Bill
GPR	\$3,900,000	\$1,600,000

B. Governor's Credit Modifications Deleted

1. Approve the Governor's recommendation to index the maximum income level and income threshold formula factors by the percentage change between the 12-month average of the CPI for the months of August through July, of the prior year, over the same 12-month average of the CPI for August, 2015, through July, 2016, rounded to the nearest \$10, as follows:

a. Index the credit for claimants aged 62 or older, whose spouse is 62 or older, who are disabled, or who have earned income. Increase the cost of the credit by \$1,300,000 in 2018-19 compared to the bill.

ALT B1a	Change to	
	Base	Bill
GPR	\$3,600,000	\$1,300,000

b. Index the credit for all claimants eligible under current law. Increase the cost of the credit by \$1,500,000 in 2018-19 compared to the bill.

ALT B1b	Change to	
	Base	Bill
GPR	\$3,800,000	\$1,500,000

2. Modify the Governor's recommendation and index all three formula factors by the percentage change between the 12-month average of the CPI for the months of August through July, of the prior year, over the same 12-month average of the CPI for August, 2015, through July, 2016, rounded to the nearest \$10, as follows:

a. Index the credit for claimants aged 62 or older, whose spouse is 62 or older, who are disabled, or who have earned income. Increase the cost of the credit by \$1,800,000 in 2018-19 compared to the bill.

ALT B2a	Change to	
	Base	Bill
GPR	\$4,100,000	\$1,800,000

b. Index the credit for all claimants eligible under current law. Increase the cost of the credit by \$2,100,000 in 2018-19 compared to the bill.

ALT B2b	Change to	
	Base	Bill
GPR	\$4,400,000	\$2,100,000

C. Delete Indexing Provisions

1. Delete the Governor's recommendation to index maximum income and income threshold formula factors. Increase the cost of the credit by \$2,500,000 in 2018-19 compared to the bill.

ALT C1	Change to	
	Base	Bill
GPR	\$0	-\$2,500,000

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