Legislative Fiscal Bureau

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May 5, 2009 Joint Committee on Finance Paper #707

Homestead Tax Credit -- Formula Changes
(Shared Revenue and Tax Relief -- Property Tax Credits)

[LFB 2009-11 Budget Summary: Page 572, #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. For claimants with income of $8,000 or less, the credit is equal to 80% of property taxes or rent constituting property taxes to a maximum of $1,450 in property taxes or rent. The maximum credit is $1,160. 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.

For purposes of calculating the credit, household income is adjusted downward by $250 for each dependent to account for family size. A dependent is defined as a person who qualifies as a dependent for federal income tax purposes, which generally must be a related person under the age of 19, unless the person is attending school, in which case the person must be under age 24. A dependent can also include a person who is permanently and totally disabled.

The credit is phased out for claimants with income between $8,000 and $24,500, at which point the credit equals zero. For claimants with less than $1,450 in allowable rent or property taxes, the credit is eliminated at lower income levels. The credit formula can be expressed as a mathematical equation for individuals with income between $8,000 and $24,500 as shown below:

Homestead Credit = 80% x [Property Taxes – 8.788% x (Household Income - $8,000)]

GOVERNOR

Beginning with calendar year 2010, increase the maximum household income amount under the homestead tax credit each year from the current level of $24,500 by the percentage change between the Consumer Price Index (CPI), as determined by the federal Department of Labor, for all urban consumers, U.S. city average, for the month of August of the previous year and the same index for the month of August, 2008. Specify that the adjustment to the maximum income level could only occur if the percentage change in the CPI is a positive number.

Specify that the revised maximum household income amount 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. Require the Department of Revenue (DOR) 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. Require DOR to annually incorporate the changes into the state income tax forms and instructions.

DISCUSSION POINTS

1. The homestead credit is a refundable credit; that is, a check from the state is issued if the amount of the credit exceeds income tax liability. The amount of the credit received by claimants depends on the interaction of household income and allowable property taxes or rent. The homestead tax credit program directs property tax relief to low-income homeowners and renters. The program is often referred to as a "circuit breaker" since it is intended to provide relief once property taxes exceed a taxpayer's ability to pay them. Credits are limited to Wisconsin residents 18 years of age or older.

2. The Governor in his Budget in Brief indicates that indexing the homestead credit is intended to assist low and moderate income families and Wisconsin seniors. According to DOR's aggregate tax data for tax year 2007, those claimants with household incomes below $15,000 totaled 143,300 (60.7% of all claimants) and received $93.7 million in tax credits (76.8% of the total) in that year. Homestead tax credit claimants over age 65 totaled 77,539 (32.8% of all claimants) and received $34.7 million in tax credits (28.5% of the total) in 2007.

3. Many believe that the homestead credit should be indexed in order to keep up with inflation so that claimants' credits do not erode as income levels increase over time. In addition, during most years of the program's history, growth in personal income compared to constant formula factors generally has resulted in lower and fewer homestead tax credits. In other words, the value of the maximum income amount becomes smaller each year in real terms, leaving fewer individuals eligible for the credit. 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 the maximum income level had increased each year at the same rate as inflation, it would be at $31,670 for tax year 2009.

4. Raising the maximum household income level at which one may receive a homestead credit would allow tax filers between the existing maximum income level and the new maximum income level to become eligible for a homestead tax credit. However, it would also lower the rate at which eligible property taxes are reduced above the income threshold ($8,000). 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 $8,000 income threshold.

5. Under the bill, the maximum household income amount for future years would be increased from $24,500 by the percentage change between the CPI for August of the previous year and the same index for August, 2008, which would be the base year for the annual adjustment. If this calculation results in a negative number, no adjustment would be made to the maximum income factor. The following table indicates how the proposed maximum income level for the homestead credit would be calculated.

TABLE 1

Proposed Indexing of Maximum Household Income Factor

Tax Year	CPI Used for Indexing Change
2010	August, 2009/August, 2008
2011	August, 2010/August, 2008
2012	August, 2011/August, 2008

6. The proposed method for indexing the maximum income level is similar to the way DOR annually indexes the state's income tax brackets and standard deduction. For tax year 2010 (taxes filed in Spring, 2011), these income tax components will be adjusted using the CPI change from August, 2008, or a prior base year to August, 2009. As a result, DOR computes these adjustments using CPI changes four months prior to the start of a tax year, and a year and four months before the taxes for that tax year could be filed. DOR completes the indexing adjustment in advance of the start of a tax year in order to be able to notify tax filers, some of whom may make estimated payments in that tax year, of the adjustments so they can adjust their estimated payment amounts.

7. Based on the provisions in the bill, the proposed formula changes could first affect the cost of the homestead tax credit in 2010-11. However, the projected change in the CPI for August, 2009, over August, 2008, results in a negative number. Therefore, there would be no adjustment to the income level for tax year 2010 claims and no change in the estimated cost of the credit in 2010-11. Similarly, based on current CPI forecasts, the projected change in CPI for the tax year 2011 (2011-12) indexing calculation (August, 2010, CPI over August, 2008, CPI) also results in a negative number and no change to the maximum income factor or the estimated cost of the credit for that year. However, if the actual CPI changes would result in a positive number and an

adjustment to the maximum income level, the cost of the credit could increase in one or both of these years.

8. If the Committee decides that it wants indexing to have a more immediate effect, August, 2007, could be used as the base year. Based on current CPI forecasts, the maximum income amount would be adjusted upward for tax years 2010 (2010-11) and 2011 (2011-12). Table 2 shows the parameters of the homestead credit under current law and under an alternative that uses August, 2007, as the base year for the indexing adjustments (Alternative 2). Attachment 1 to this paper indicates the estimated change in the credit that would be received in 2010 by claimants at various income and property tax levels under this alternative. This would increase the estimated cost of the credit by $2.9 million in 2010-11 and $5.9 million in 2011-12, the first year of the next biennium.

TABLE 2

Indexing of Maximum Household Income Factor
Using August, 2007, as the Base Year

	Current Law	2010	2011
Maximum Income	$24,500	$25,010	$25,490
Maximum Property Taxes	1,450	1,450	1,450
Property Tax Reimbursement Rate	80%	80%	80%
Income Threshold	8,000	8,000	8,000
Rate that Income Reduces Eligible Taxes	8.788%	8.524%	8.290%
Maximum Credit	1,160	1,160	1,160

Alternatives to the Governor's Proposal

9. As part of the 2007-09 biennial budget, the Governor recommended indexing the credit's maximum income level, maximum property tax or rent constituting property tax amount, and income threshold formula factors. The Committee could decide to use this approach for indexing, using either the August, 2008, or August, 2007, base year for the indexing calculation, depending on whether the Committee wants an immediate or delayed effect. Using August, 2008, as the base year would result in no indexing adjustments for the 2010 or 2011 tax years, based on current CPI forecasts (Alternative 3). Using August, 2007, as the base year would establish the following estimated formula factors for the 2010 and 2011 tax year credits.

TABLE 3

Indexing Three Formula Factors
(August, 2007, Base Year for Indexing)

	Current Law	2010	2011
Maximum Income	$24,500	$25,010	$25,490
Maximum Property Taxes	1,450	1,480	1,510
Property Tax Reimbursement Rate	80%	80%	80%
Income Threshold	8,000	8,170	8,320
Rate that Income Reduces Eligible Taxes	8.788%	8.789%	8.794%
Maximum Credit	1,160	1,184	1,208

10. Raising the maximum amount of property taxes or rent constituting property taxes would increase the potential maximum credit for those claimants below the income threshold. Claimants above the threshold who have property taxes above the current law maximum of $1,450 would also receive higher credits. Claimants with incomes between $8,000 and the adjusted threshold level would receive an increase in their credit regardless of their property tax level. In addition, because there would be no reduction in their credit associated with the portion of their income between $8,000 and the adjusted income threshold, many claimants with incomes above the adjusted income threshold would begin to receive a credit or receive an increase in their credit.

11. Adjusting these three formula factors using August, 2007, as the base year for the indexing calculation would increase the cost of the credit by an estimated $5.0 million in 2010-11 (Alternative 4) and $9.9 million in 2011-12. Attachment 2 indicates the estimated change in the credit that would be received by claimants at various income and property tax levels if these three formula factors would be indexed for the 2010 tax year using August, 2007, as the base year.

12. Some policymakers contend that the tax relief provided through tax credits should target lower income families with children. For example, in recent years, the federal government increased the per child tax credit to $1,000 per child for households below certain income levels. Past proposals aimed at targeting the homestead tax credit to families with children have focused on increasing the $250 per dependent deduction to the claimant's household income. Increasing the deduction to household income from $250 per dependent to $1,000 per dependent would increase the estimated cost of the credit, compared to current law, by $3.1 million in 2010-11 (Alternative 5).

13. Increasing the income deduction per dependent would increase the tax credit for current recipients by reducing the amount of household income used to phase out the credit. Additional tax filers with dependents may also qualify for the credit if the larger deduction lowers their income below the maximum income level of $24,500. Table 4 provides an example showing that increasing the income deduction from $250 to $1,000 per dependent would increase the homestead tax credit for this claimant with three dependents from $299 under current law to $457, or by $158.

TABLE 4

Comparison of the Homestead Credit Under Current Law and a $1,000 per Dependent Income Reduction Alternative

	Current Law	Alternative
Household Income	$21,000	$21,000
Deduction for Three Dependents	750	3,000
Adjusted Household Income	20,250	18,000
Property Taxes/Rent	$1,450	$1,450
Homestead Tax Credit	$299	$457

14. Table 5 shows the income deduction and homestead tax credit increase that would be received by claimants if the household income deduction were increased from $250 to $1,000 per dependent. The amounts are based on the current law amounts for all other formula factors. The increase in the credit would be less than the amounts listed if the increased deduction would place a claimant's income below the current $8,000 income threshold (claimants currently below $8,000 in income would receive no increase). In addition, the credit amounts would be less than the amounts shown for those tax filers who would gain eligibility for the credit because the $1,000 per dependent deduction would lower their income below the current maximum income level of $24,500.

TABLE 5

Potential Increase in Homestead Credit Under a $1,000 Per Dependent Income Reduction Alternative

Number of Dependents	Additional Income Deduction	Credit Increase
One	$750	$53
Two	1,500	106
Three	2,250	158
Four	3,000	211
Five	3,750	264

12-Month Average CPI Change

15. The Governor's proposal would adjust the maximum household income level under the credit each year by the percentage change between the CPI, for one month of a year, over that same month in 2008. This type of indexing adjustment could lead to larger swings in the percentage

change used to index the maximum income factor than if a 12-month average for the August through July period were used. For example, under the Governor's proposed indexing provisions, a short-term rise in the CPI that includes the month of August in a given year could produce a larger adjustment to the maximum income level than if that short-term rise was smoothed out using a 12-month average. However, using a month over month methodology would be consistent with how DOR has indexed the state's income tax brackets since 1998.

16. Other annual indexing adjustments used by the state and federal government use a change in the CPI for one 12-month average over the average for the same 12-month period in a prior year. In the past, the state indexed its motor vehicle fuel tax rate each year by using the average for the 12 months in the prior year over the average for the same 12 months of the preceding year. The federal government uses the average CPI for the 12-month period ending August 31 compared with the average CPI for the appropriate 12-month base period to adjust several federal income tax provisions each year, including the standard deduction and the federal income tax brackets. Therefore, using a 12-month average when indexing the credit factors instead of a month over month methodology may help moderate some of the potential volatility (Alternative 6).

ALTERNATIVES

1. Approve the Governor's recommendation to index the homestead tax credit maximum income level formula factor by the percentage change between the CPI for the month of August of the previous year and the CPI for the month of August, 2008, rounded to the nearest $10. Specify that the adjustment to the maximum income level could only occur if the percentage change in the CPI is a positive number. Specify that the income factor would first be indexed for calendar year 2010. (Because this indexing calculation is expected to result in a negative number, there would be no change to the maximum income factor or to the estimated cost of the credit in the biennium).

2. Modify the Governor's recommendation by indexing the homestead tax credit maximum income level formula factor by the percentage change between the CPI for the month of August of the previous year and the CPI for the month of August, 2007 (one year earlier than the Governor's recommendation), rounded to the nearest $10. Increase the estimated cost of the credit, compared to current law, by $2,900,000 GPR in 2010-11.

ALT 2	**Change to Bill** Funding
GPR	$2,900,000

3. Delete the Governor's recommendation and, instead, index the homestead tax credit maximum income level, maximum property tax amount, and income threshold formula factors by the percentage change between the CPI for the month of August of the previous year and the CPI for the month of August, 2008, rounding each factor to the nearest $10. Specify that the adjustments

could only occur if the percentage change in the CPI is a positive number. Specify that these factors would first be indexed for calendar year 2010. (Because the indexing calculation under this alternative is expected to result in a negative number, there would be no change to the formula factors or to the estimated cost of the credit in the biennium).

4. Delete the Governor's recommendation and, instead, index the homestead tax credit maximum income level, maximum property tax amount, and income threshold formula factors by the percentage change between the CPI for the month of August of the previous year and the CPI for the month of August, 2007, rounding each factor to the nearest $10. Specify that the adjustments could only occur if the percentage change in the CPI is a positive number. Specify that these factors would first be indexed for calendar year 2010. Increase the estimated cost of the credit, compared to current law, by $5,000,000 GPR in 2010-11.

ALT 4	**Change to Bill** Funding
GPR	$5,000,000

5. Increase the per dependent income deduction from $250 to $1,000, beginning with tax year 2010. This would increase the estimated cost of the credit, compared to current law, by $3,100,000 GPR in 2010-11. [This alternative could be adopted in addition to Alternatives 1, 2, 3, 4, or 7.]

ALT 5	**Change to Bill** Funding
GPR	$3,100,000

6. Specify that the percentage change in the CPI used for adjusting any formula factors associated with the credit would use the change in the 12-month average of the CPI for August through July of the prior year over the 12-month average of the CPI for August through July of the base year. [This alternative could be adopted in addition to Alternatives 1, 2, 3, or 4].

7. Delete provision.

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Attachments

ATTACHMENT 1

Comparison of Current Law Credit to Credit Using a $25,010 Maximum Income Level

	Property Taxes										
Income	$700	$800	$900	$1,000	$1,100	$1,200	$1,300	$1,450	$1,650	$1,800	$2,000
Current Law Credit											
$0	$560	$640	$720	$800	$880	$960	$1,040	$1,160	$1,160	$1,160	$1,160
8,000	560	640	720	800	880	960	1,040	1,160	1,160	1,160	1,160
10,000	419	499	579	659	739	819	899	1,019	1,019	1,019	1,019
12,000	279	359	439	519	599	679	759	879	879	879	879
14,000	138	218	298	378	458	538	618	738	738	738	738
16,000	0	78	158	238	318	398	478	598	598	598	598
18,000	0	0	17	97	177	257	337	457	457	457	457
20,000	0	0	0	0	36	116	196	316	316	316	316
22,000	0	0	0	0	0	0	56	176	176	176	176
24,000	0	0	0	0	0	0	0	35	35	35	35
25,000	0	0	0	0	0	0	0	0	0	0	0
Proposed Expansion											
$0	$560	$640	$720	$800	$880	$960	$1,040	$1,160	$1,160	$1,160	$1,160
8,000	560	640	720	800	880	960	1,040	1,160	1,160	1,160	1,160
10,000	424	504	584	664	744	824	904	1,024	1,024	1,024	1,024
12,000	287	367	447	527	607	687	767	887	887	887	887
14,000	151	231	311	391	471	551	631	751	751	751	751
16,000	14	94	174	254	334	414	494	614	614	614	614
18,000	0	0	38	118	198	278	358	478	478	478	478
20,000	0	0	0	0	62	142	222	342	342	342	342
22,000	0	0	0	0	0	5	85	205	205	205	205
24,000	0	0	0	0	0	0	0	69	69	69	69
25,000	0	0	0	0	0	0	0	1	1	1	1
Proposed Expansion -- Change to Current Law											
$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
8,000	0	0	0	0	0	0	0	0	0	0	0
10,000	5	5	5	5	5	5	5	5	5	5	5
12,000	8	8	8	8	8	8	8	8	8	8	8
14,000	13	13	13	13	13	13	13	13	13	13	13
16,000	14	16	16	16	16	16	16	16	16	16	16
18,000	0	0	21	21	21	21	21	21	21	21	21
20,000	0	0	0	0	26	26	26	26	26	26	26
22,000	0	0	0	0	0	5	29	29	29	29	29
24,000	0	0	0	0	0	0	0	34	34	34	34
25,000	0	0	0	0	0	0	0	1	1	1	1

ATTACHMENT 2

Comparison of Current Law Credit to Credit Under Indexing of All Three Formula Factors Using a 2007 CPI Base

	Property Taxes										
Income	$700	$800	$900	$1,000	$1,100	$1,200	$1,300	$1,450	$1,650	$1,800	$2,000
Current Law Credit											
$0	$560	$640	$720	$800	$880	$960	$1,040	$1,160	$1,160	$1,160	$1,160
8,000	560	640	720	800	880	960	1,040	1,160	1,160	1,160	1,160
10,000	419	499	579	659	739	819	899	1,019	1,019	1,019	1,019
12,000	279	359	439	519	599	679	759	879	879	879	879
14,000	138	218	298	378	458	538	618	738	738	738	738
16,000	0	78	158	238	318	398	478	598	598	598	598
18,000	0	0	17	97	177	257	337	457	457	457	457
20,000	0	0	0	0	36	116	196	316	316	316	316
22,000	0	0	0	0	0	0	56	176	176	176	176
24,000	0	0	0	0	0	0	0	35	35	35	35
25,000	0	0	0	0	0	0	0	0	0	0	0
Proposed Expansion											
$0	$560	$640	$720	$800	$880	$960	$1,040	$1,160	$1,184	$1,184	$1,184
8,000	560	640	720	800	880	960	1,040	1,160	1,184	1,184	1,184
10,000	431	511	591	671	751	831	911	1,031	1,055	1,055	1,055
12,000	291	371	451	531	611	691	771	891	915	915	915
14,000	150	230	310	390	470	550	630	750	774	774	774
16,000	9	89	169	249	329	409	489	609	633	633	633
18,000	0	0	29	109	189	269	349	469	493	493	493
20,000	0	0	0	0	48	128	208	328	352	352	352
22,000	0	0	0	0	0	0	68	188	212	212	212
24,000	0	0	0	0	0	0	0	47	71	71	71
25,000	0	0	0	0	0	0	0	0	1	1	1
Proposed Expansion -- Change to Current Law											
$0	$0	$0	$0	$0	$0	$0	$0	$0	$24	$24	$24
8,000	0	0	0	0	0	0	0	0	24	24	24
10,000	12	12	12	12	12	12	12	12	36	36	36
12,000	12	12	12	12	12	12	12	12	36	36	36
14,000	12	12	12	12	12	12	12	12	36	36	36
16,000	9	12	12	12	12	12	12	12	36	36	36
18,000	0	0	12	12	12	12	12	12	36	36	36
20,000	0	0	0	0	12	12	12	12	36	36	36
22,000	0	0	0	0	0	0	12	12	36	36	36
24,000	0	0	0	0	0	0	0	12	36	36	36
25,000	0	0	0	0	0	0	0	0	1	1	1