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May 18, 2017 Joint Committee on Finance Paper #572

Homestead Tax Credit -- Limit the Credit to Those 62 or Older, Disabled, or with Earned Income (Shared Revenue and Tax Relief -- Property Tax Credits)

[LFB 2017-19 Budget Summary: Page 412, #5]

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:

Homestead Credit = 80% x [Property Taxes - 8.785% x (Household Income - $8,060)]

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

GOVERNOR

For homestead tax credit claims filed for tax year 2018 and thereafter, limit the credit to claimants who are 62 years of age or older, claimants whose spouse is 62 or older, those with disabilities, and those who have earned income. All other claimants eligible under current law would no longer be eligible for the credit after tax year 2017. Reduce the credit funding by $12,200,000 in 2018-19 to reflect the estimated impact of this recommendation.

Eligible claimants 62 years of age or older, claimants whose spouse is 62 or older, and those who are disabled would continue to receive a homestead tax credit calculated as the credit is calculated under current law. "Disabled" claimants would be defined as any individual who is unable to engage in any substantial gainful employment due to a medically determinable physical or mental impairment which has lasted or is expected to last for a continuous period of at least 12 months. To receive the credit, disabled claimants would be required to provide proof his or her disability is in effect for the taxable year. For these claimants, the current law maximum property tax or rent amount of $1,460, the maximum credit amount of $1,168, and the credit reduction rate of 8.785% would continue to apply. However, under a separate provision, the income threshold of $8,060 and the maximum income level of $24,680 would be indexed annually beginning in calendar year 2018 (see LFB Paper #573).

Non-disabled claimants under the age of 62 would be eligible for a modified credit, but only if the claimant has earned income in the year to which the claim relates. These claimants would receive a credit equal to the lesser amount calculated under two separate formulas, one of which is the current law credit formula and the other would be a formula based on the claimant's earned income. For eligible claimants with household income below the current law income threshold of $8,060, the claimant would receive the lesser of the current law credit or a credit equal to 16% of the claimant's earned income in that tax year. For eligible claimants with household income above the income threshold of $8,060 (up to $24,680), the claimant would receive the lesser of the current law credit or a credit equal to 80% of the amount by which 20% of the claimant's earned income in that tax year exceeds 8.785% of the claimant's household income in excess of $8,060.

Attachment 1 to this paper provides a more detailed explanation of the modifications to the credit.

DISCUSSION POINTS

Governor's Proposal

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 $12.2 million fiscal effect of the Governor's proposed changes is based on the $101.2 million adjusted base amount. However, due to the estimated reduction in the overall size of the current law credit compared to the base level amount, the fiscal effect of the proposed changes is reestimated downward by $800,000 in 2018-19 compared to the bill.

This reestimate would result in an $11.4 million reduction in the credit compared to base level funding associated with these proposed changes to the credit [Alternative 1].

2. The Governor's proposal would eliminate the homestead credit for currently eligible claimants that do not have earned income. The Governor's proposal would then create two separate credits: (a) those who are 62 years old, have a spouse who is 62 years old, or are disabled would continue to receive the current law credit; (b) those who are non-disabled claimants under the age of 62 with earned income would be eligible for a modified credit. Attachment 1 to this paper provides a more detailed explanation of the proposed modifications to the credit.

3. In total, the Governor's proposal would eliminate or reduce credits for approximately 22,100 claimants. The total number of claimants who would lose a credit under the Governor's proposal is estimated to be 11,300. In addition, an estimated 10,800 claimants would receive a reduced credit.

4. The administration indicates that creating a separate credit for claimants aged 62 or older or disabled would bring the credit back to its original intent, which was to provide property tax relief to senior homeowners and renters. (Originally, the credit was limited to homeowners and renters aged 65 or older.) The credit was established in 1964 as a program to relieve low-income homeowners and renters of excessive property taxes compared to their ability to pay. The contention was that older residents tend to be on fixed incomes, which can limit their ability to meet rising property tax bills. As part of refocusing the credit to its original intent, the Governor has also proposed indexing the existing homestead credit formula for those 62 or older or disabled (see LFB Paper #573).

5. Under the Governor's proposal, it is estimated that claimants between the ages of 50 and 59 would experience the greatest change in total credit amounts by either receiving a reduced credit or losing their entire credit. Claimants younger than 30 years of age would receive the lowest estimated change in their credit amount due to a reduced or eliminated credit. The following table indicates the estimated credit change for each age group.

TABLE 1

Age of Claimants with Reduced or Eliminated Credits Under the Governor's Proposal

	Claimants with Reduced Credits		Claimants with Eliminated Credits	
Age Group	Count of Claims	Credit Change	Count of Claims	Credit Change
Younger than 30	2,000	-$685,000	1,000	-$522,000
30 to 39	2,100	-620,000	2,000	-1,477,000
40 to 49	2,100	-947,000	2,900	-1,610,000
50 to 59	4,000	-1,595,000	3,900	-2,792,000
60 and 61	600	-240,000	1,500	-912,000
Total	10,800	-$4,087,000	11,300	-$7,313,000

6. In order to target credits to lower income families, the current law credit provides additional support to claimants with dependents by allowing for a $500 downward adjustment to household income for each dependent that lives with the claimant. The Governor's proposal would cause some claimants with dependents to receive a reduced credit or lose their credit entirely. Of the 10,800 claimants who would receive a reduced credit under the Governor's proposal, 3,500 of those claimants have nearly 6,000 dependents. Of the 11,300 claimants who would lose their credit entirely under the Governor's proposal, 3,200 of those claimants have nearly 5,200 dependents.

Limiting the Modified Credit to Those With Earned Income

7. The Governor's Budget in Brief indicates that the Governor's budget recommendations include a number of provisions that are intended to reward labor force participation under his proposed welfare reform package, "Wisconsin Works for Everyone." According to the administration, an objective of this initiative is to help those "disconnected from employment realize their potential in the workforce." Making a modified homestead credit only available to those with earned income is one of those provisions. However, while some may contend that public assistance programs for low-income individuals reduce labor-force participation by discouraging work and increasing dependency, others assert that public assistance programs actually benefit low-income individuals by helping reduce poverty and food insecurity and increase economic mobility, which can have positive impacts on the state's economy.

8. According to the administration, the Governor's intent was to more closely align the eligibility requirements of the homestead credit to those of the earned income tax credit (EITC). Whereas claimants can have no or negative earned income and remain eligible for a homestead credit, the EITC requires claimants to have positive earned income to receive the credit. Using tax year 2014 data, approximately 6,600 (3.4%) current law credit claimants had negative WAGI for homestead credits claimed in tax year 2014.

9. Currently, homestead credit claimants must report their household income in order to receive the credit. For the purposes of calculating the credit, household income is broadly defined to reflect most cash resources available to claimants. Claimant income starts with Wisconsin adjusted gross income (WAGI). Claimants are then required to report a number of statutorily-specified household income "addbacks" to WAGI, such as unemployment compensation, capital gains, business losses, contributions to IRAs, and child support. Some claimants who do not file an income tax return file a homestead only tax form, on which claimants must report components of WAGI that would have otherwise been reported on the income tax form, along with the same "addbacks" to income. Attachment 2 to this paper lists the "addbacks" to WAGI required under current law.

10. The following table provides the percentages of the primary sources of non-wage household income "addbacks" for claimants who would lose their credit entirely (no earned income) or receive a reduced credit (earned income less than $7,300) under the Governor's proposal.

TABLE 2

Non-Wage Household Income "Addbacks" for Claimants with Eliminated or Reduced Credits Under the Governor's Proposal

Income Type	% of Non-Wage Income "Addbacks" Eliminated Credit	Reduced Credit
Unemployment compensation	38.5%	39.2%
Depreciation, operating, or capital losses	17.7	46.9
Pension, annuities, and railroad retirement benefits	16.6	0.5
Child support, maintenance payments, other support	10.6	7.4
Taxable interest and dividends and other non-taxable capital gains	7.2	0.3
Wisconsin Works (W2), county relief, kinship care, and other cash public assistance	3.2	1.3
Worker's compensation, income continuation, and loss of time insurance	3.0	0.0
Scholarships, fellowships, grants, and military compensation	3.0	2.9
Other	0.2	1.5
Total	100.0%	100.0%

11. Table 2 provides an indication of the types of non-wage "addbacks" to household income reported by those claimants who would be affected under the Governor's proposal. As shown, a majority (56.2%) of the income "addbacks" reported by those who would have their credit eliminated was associated with unemployment compensation (38.5%) or depreciation, operating, or capital losses (17.7%). Similarly, for those that would receive a reduced credit, most (86.1%) of the sources non-wage "addbacks" were associated with those same two income sources. Other significant household income "addback" categories for those claimants include pension or annuity income and child support.

12. If the intent of the Governor's earned income requirement is to reward those that have earned income or wages, the distribution in Table 2 suggests that the majority of affected claimants are not the claimants such a proposal is intending to target -- non-disabled, working age claimants without earned income who do not participate in the labor force. Rather, the proposal primarily eliminates or reduces credits for claimants who may have temporarily lost their job and currently claim unemployment and claimants who are self-employed and have business losses in the year to which the credit relates. The distribution also suggests that other types of claimants who would be targeted include early retirees, those on child support, and those with interest, dividend, and capital gain income.

13. The administration has stated that the intent of the Governor's proposed changes to the credit are met under the modified formula. For example, administration officials indicate that claimants receiving unemployment compensation who would receive a reduced or eliminated credit would maintain the Governor's intent that such claimants should not receive the credit because they are capable of finding work. They indicate the intent of the modified credit is to reward those who find work and those who are working. Similarly, they note that reducing or

eliminating the homestead credit for those with operating or capital losses is also consistent with the intent of the proposed credit modifications, because those individuals are not generating any income.

14. However, if the intent of the modified credit is to eliminate the credit for those claimants who are capable of working, but instead receive only public assistance, it would seem that the impact of the earned income requirement on such claimants would be limited. As shown in Table 2, Wisconsin Works (W2) benefits, county relief, kinship care, and other cash public assistance or worker's compensation, income continuation, and loss of time insurance would only make up a combined 6.2% of the income "addbacks" for those who would lose their credit entirely and only 1.3% for those would receive a reduced credit. This may be due to the fact that under current law, those on W2 benefits must reduce the amount of their eligible rent or property taxes by 1/12 for every month the claimant receives W2 benefits. Further, such claimants must add back those benefits so they are included in their household income, which has the effect of further reducing their credit.

15. The Governor has proposed increasing funding for the earned income tax credit (EITC), which, in conjunction with his proposal to eliminate homestead credits for claimants without earned income, demonstrates his intention to reward labor force participation. The Governor has also proposed establishing a disqualification for potential claimants with business and investment losses in excess of $15,000 in the tax year they are attempting to claim either the EITC or the homestead credit (see LFB Paper #574). As stated in the Budget in Brief, this provision would "ensure that the homestead credit and earned income tax credit are only paid to those who are truly in need." However, eliminating the homestead credit for claimants without earned income could be seen as counterintuitive to the Governor's intention to provide the credit as a form of relief to those in need because those that meet the income eligibility are often without significant earned income and most in need [Alternative 3].

Modified Credit Formula for Those with Earned Income

16. The Governor's proposed modified credit formula would reduce homestead credits for claimants with earned income below $7,300. Any claimant with $7,300 or more in earned income would receive the same credit as they would under current law. As mentioned earlier, the total number of claimants who would receive a reduced credit under the modified credit is estimated to be 10,800.

17. Under current law, the homestead credit erodes for claimants with household income greater than $8,060 as income approaches the maximum level of $24,680. Through this method, the formula is more generous to claimants with lower household incomes. The following table demonstrates the change in credits between the current law credit and the modified credit for eligible claimants under hypothetical combinations of household income, earned income, and property taxes. As shown, there would be no change in credit amounts for claimants with earned incomes greater than $7,300. However, claimants with earned income below $7,300 would receive reductions that would become greater as earned income declines from the $7,300 level.

TABLE 3

Change in Credit Under the Modified Credit Formula for Eligible Claimants with Earned Income

Household Income	Earned Income	Property Taxes $800	$900	$1,000	$1,200	$1,400	$1,600
$3,000	$0	-$640	-$720	-$800	-$960	-$1,120	-$1,168
4,000	1,300	-432	-512	-592	-752	-912	-960
5,000	2,300	-272	-352	-432	-592	-752	-800
6,000	3,300	-112	-192	-272	-432	-592	-640
7,000	4,300	0	-32	-112	-272	-432	-480
8,000	5,300	0	0	0	-112	-272	-320
9,000	6,300	0	0	0	0	-112	-160
10,000+	7,300+	0	0	0	0	0	0

18. The homestead tax credit 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. The underlying principle of the "circuit breaker" function is that taxes exceeding a certain percentage of income constitute an overload to the taxpayer and should be partially offset by the tax relief from the credit. As a result, this function can be seen as an effective means of transitioning claimants off of the credit as incomes rise. The Governor's proposal would maintain the circuit breaker function for claimants with earned income above $7,300. These claimants would continue to receive the current law credit, which would continue to become smaller as claimants' incomes (and their ability to pay property taxes) rise. The modified formula would have the exact opposite function as the circuit breaker function of the current credit for claimants with incomes below $7,300. For such claimants, the modified credit would become smaller as their earned income (and their ability to pay property taxes) declines or approaches $0. However, administration officials indicate that, consistent with the Governor's intent to reward work, the modified credit would provide larger credits to claimants who are working more and seeing their earned incomes rise.

19. If the Committee is concerned about establishing a credit that declines as earned income declines, but would like to retain the earned income test, the Committee could delete the proposed modified credit formula, but include the Governor's provision that requires a claimant to have earned income to be eligible for the current law credit. Under this alternative, all claimants with earned income, as well as those 62 years of age or disabled, would be eligible for the current law credit [Alternative 2]. Compared to the Governor's proposal, the total number of claimants would increase by an estimated 2,000 claimants (1.1%), and the total amount of credits would increase by an estimated $5.2 million (6.3%) under this alternative. One potential downfall to this alternative is that it would create an "income cliff" related to eligibility in that those with $0 earned income or less would not be eligible for the credit, while those with incomes just above $0 would be eligible for the credit and potentially the maximum credit. However, the household income addbacks to WAGI would continue to apply to those with limited earned income, so the "income cliff" would be somewhat mitigated.

20. Compared to current law, the Governor's proposal would have the opposite effect on the count of homestead credits distributed during economic recessions. Under current law, the number of claimants and amount of credit expenditures increase during recessions when incomes and employment levels decline. Under the Governor's proposal, claimants and credit expenditures would likely decrease during recessions when employment and wages decline due to the proposed earned income requirement. Although this change would benefit the state in fiscal terms, it would negatively affect low-income earners who would otherwise benefit from the homestead credit during economic recessions [Alternative 3].

ALTERNATIVES

1. Approve the Governor's recommendation to modify the homestead credit program for homestead tax credit claims filed for tax year 2018 and thereafter. Eliminate the credit for those claimants that do not have earned income and maintain the current law credit for claimants who are 62 years of age or older, claimants whose spouse is 62 or older, and for those with disabilities. All other claimants with earned income would be eligible for a credit under a modified credit formula. Increase the estimated costs of the credit by $800,000 in 2018-19 to reflect the reestimate of the Governor's proposed modifications to the credit.

ALT 1	**Change to**	
	Base	**Bill**
GPR	- $11,400,000	$800,000

2. Modify the Governor's proposal so that all claimants aged 62 or older, disabled, or with earned income would be eligible for the current law credit. Those without earned income would be eliminated from the credit. Increase the estimated funding for the credit by $5,200,000 in 2018-19 compared to the bill.

ALT 2	**Change to**	
	Base	**Bill**
GPR	- $6,200,000	$5,200,000

3. Delete provision. Increase the cost of the credit by $12,200,000 in 2018-19 compared to the bill.

ALT 3	**Change to**	
	Base	**Bill**
GPR	$0	$12,200,000

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Attachments

ATTACHMENT 1

Modified Formula for Non-Disabled Claimants Under Age 62 With Earned Income

Claimants with household income below the current law income threshold of $8,060 would receive the lesser of the current law credit or a credit equal to 16% of the claimant's earned income in that year. For example, a claimant with a household income of $7,500, earned income of $7,200, and property taxes or rent of $1,460 would receive a credit equal to the lesser of the following amounts, up to a maximum credit of $1,168:

Proposed Credit

Homestead tax credit = 16% x earned income

Homestead tax credit = 16% x $7,200 = $1,152

or

Current Law Credit

Homestead tax credit = 80% x property taxes or rent

Homestead tax credit = 80% x $1,460 = $1,168

Claimants with household income above the current law income threshold of $8,060 (up to $24,680) would receive the lesser of the current law credit or a credit equal to 80% of the amount by which 20% of the claimant's earned income in that tax year exceeds 8.785% of the claimant's household income in excess of $8,060. For example, a claimant with a household income of $20,000, earned income of $15,000, and property taxes or rent of $1,460 would receive a credit equal to the lesser of the following amounts, up to a maximum credit of $1,168:

Proposed Credit

Homestead tax credit = 80% x [(20% x earned income) - 8.785% x (household income - $8,060)]

Homestead tax credit = 80% x [(20% x $15,000) - 8.785% x ($20,000 - $8,060)] = $1,561

($1,561 is greater than the maximum credit amount of $1,168, so the credit = $1,168)

or

Current Law Credit

Homestead tax credit = 80% x [property taxes or rent - 8.785% x (household income - $8,060)]

Homestead tax credit = 80% x [$1,460 - 8.785% x ($20,000 - $8,060)] = $329

ATTACHMENT 2

Sources of Income Included in "Household Income" Under the Homestead Tax Credit Program

Household income means Wisconsin adjusted gross income (AGI) plus the following amounts to the extent not included in Wisconsin AGI:

- Support money
- Cash public assistance (not including credits from this program or amounts granted under the community options program for long-term support) and cash benefits paid under county relief programs
- Maintenance payments (except that foster care maintenance and supplementary foster care payments are excludable)
- Gross amount of any pension or annuity
- Railroad retirement benefits
- Social security benefits
- Veterans disability pensions
- Nontaxable interest received from the federal government, or any of its instrumentalities
- Nontaxable interest received on state and municipal bonds
- Worker's compensation
- Unemployment compensation
- Gross amount of "loss of time" insurance
- Compensation and other cash benefits received from the United States for past or present services in the armed forces
- Scholarship, fellowship, or educational grants, gifts, or income
- Capital gains
- Gain on the sale of a personal residence that is excluded from taxable income
- Dividends
- Income of a nonresident or part-year resident who is married to a full-year resident
- Housing allowances provided to members of the clergy
- Amount by which a resident manager's rent is reduced
- Nontaxable income of an American Indian
- Nontaxable income from sources outside this state
- Nontaxable deferred compensation
- Intangible drilling costs
- Depletion allowances and depreciation
- Amortization
- Contributions to individual retirement accounts
- Contributions to Keogh plans
- Net operating loss carry-forwards and carry-backs
- Capital loss carry-forwards