



Legislative Fiscal Bureau

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

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Joint Committee on Finance

Paper #717

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

Bill Agency

[LFB 2007-09 Budget Summary: Page 509, #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:

$$\text{Homestead Credit} = 80\% \times [\text{Property Taxes} - 8.788\% \times (\text{Household Income} - \$8,000)]$$

GOVERNOR

Beginning with tax year 2008, increase the maximum household income amount under the homestead tax credit each year from the current level of \$24,500 by a percentage equal to the percentage change between the consumer price index (CPI) 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, 2006.

Specify that 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.

Increase funding by \$4,000,000 GPR in 2007-08 and \$8,000,000 GPR in 2008-09 to reflect these changes.

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. Based on the provisions in the bill, the proposed formula changes would first affect the homestead tax credit in tax year 2008. However, subsequent to the bill being introduced, the Department of Administration, in a memorandum to the Joint Committee on Finance, indicated that it was the Governor's intent that the formula changes should first be effective in tax year 2007. The memorandum indicated that it was also the Governor's intent to index the maximum household income and property tax amounts and the income threshold to the percentage change between the CPI for the month of August of the previous year and the CPI for the month of August, 2005.

3. The bill would increase funding by \$4,000,000 in 2007-08 and \$8,000,000 in 2008-09 to fund the proposed expansion of the homestead tax credit. These estimates were completed by DOR prior to the introduction of the bill, using estimated changes in CPI for August, 2007, over August, 2006, to derive the change in funding for 2007-08 and August, 2008, over August, 2006, to derive the change in funding for 2008-09. However, under the Governor's revised proposal, the maximum income level, maximum property tax level, and income threshold level would be indexed using the percentage changes in the CPI for periods one year earlier than those used by DOR.

4. As a result of the difference in indexing adjustments, the credit factors and the estimated cost of the credit differ from the amounts estimated under the bill. The following chart shows the parameters of the homestead credit under current law, the estimates under the bill, and the revised proposal. The attachment to this paper indicates the change in the credit that would be received by claimants at various income and property tax levels under the revised proposal.

	<u>Current Law</u>	<u>Tax Year 2007</u>		<u>Tax Year 2008</u>	
		<u>Bill Estimate</u>	<u>Revised</u>	<u>Bill Estimate</u>	<u>Revised</u>
Maximum Income	\$24,500	\$24,970	\$25,430	\$25,420	\$26,010
Maximum Property Taxes	1,450	1,480	1,510	1,500	1,540
Property Tax Reimbursement Rate	80%	80%	80%	80%	80%
Income Threshold	8,000	8,150	8,300	8,300	8,490
Rate that Income Reduces					
Eligible Taxes	8.788%	8.799%	8.815%	8.762%	8.790%
Maximum Credit	1,160	1,184	1,208	1,200	1,232

5. Accounting for the difference in the factors indexed and the base year for the initial indexing adjustment and for modest differences in the estimated inflation, property taxes, and rent in the biennium, it is estimated that the cost of the credit would increase by \$10.3 million in 2007-08 and \$16.1 million in 2008-09 under the proposed formula changes. This is an increase of \$6.3 million in 2007-08 and \$8.1 million in 2008-09 compared to the bill.

6. The Governor in his Budget in Brief indicates that the increase in 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 2005, homestead tax credit claimants age 65, or older, totaled 88,813 (36.9% of all claimants) and received \$41.3 million in tax credits (33.9% of the total). Those with household incomes below \$15,000 totaled 145,308 (60.7% of all claimants) and received \$93.0 million in tax credits (76.3% of the total).

7. The homestead tax credit program directs property tax relief to low income homeowners and renters. The local levy limit enacted under 2005 Act 25, along with increased state aids to local taxing jurisdictions, has helped limit the property tax levy increases on a median valued home in recent years. The Governor is recommending a somewhat less restrictive levy limit under the bill, plus several aid increases. As a result of these actions, estimated property taxes on a median valued home increased by 0.9% in tax year 2005, and are estimated to increase 0.1% in tax year 2006, 3.4% in tax year 2007, and 1.7% in tax year 2008. Over this period, the total increase was 6.3%, compared to a 10.8% increase in CPI. Therefore, the state policy of attempting to limit property tax increases through levy limits and additional state aid to local units of government may make an inflationary increase in the homestead tax credit formula factors less necessary at this time. However, in any given year, homeowners in some communities experience tax increases considerably above those based on statewide averages.

8. Conversely, 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 \$30,732 for tax year 2007.

Alternatives to the Governor's Proposal

9. Prior to 1973, only those 65, or older, were eligible for the homestead tax credit. In 1973, the program was expanded to include any person age 18 or older who satisfied income and other eligibility requirements. In recent years, some have proposed that the homestead tax credit again be targeted at seniors.

10. For many Wisconsin senior citizens, social security income makes up a large percentage of their income. Each year, the Social Security Administration adjusts social security payments for inflation under an annual cost of living adjustment. The proposed indexing of the homestead credit formula factors would help ensure Wisconsin seniors that these annual increases do not result in a reduction in their homestead tax credits. However, if concern exists about the cost of expanding the program for all eligible claimants, the proposed expansion could be limited to those 65, or older. Applying the proposed adjustments to the formula factors for only those eligible claimants who are 65 or older would increase the estimated cost of the credit by \$4.0 million in 2007-08 and \$6.4 million in 2008-09. Compared to the original estimates in the bill, this alternative would result in no change in the estimated cost of the credit in 2007-08 and would reduce the estimated cost of the credit by \$1.6 million in 2008-09.

11. If the proposed expansion to the homestead credit was limited to those 65, or older, the change in the credit received for various income and property tax levels identified in the attachment to this paper would also apply to the eligible seniors under this alternative.

12. Alternatively, 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 household income level used in determining a claimant's tax credit. 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 \$3.3 million in 2007-08 and \$3.2 million in 2008-09.

13. Under the homestead credit, as household income rises, the credit is phased out. Therefore, 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. The following table shows that increasing the income deduction from \$250 to \$1,000 per dependent would increase the homestead tax credit for a claimant with three dependents from \$299 under current law to \$457, or by \$158.

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

	<u>Current Law</u>	<u>Alternative</u>
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. The following table 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.

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

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

ALTERNATIVES TO BILL

1. Approve the Governor's revised recommendation to index the homestead tax credit maximum income level, maximum property tax amount, and income threshold formula factors to the percentage change between the CPI for the month of August of the previous year and for the month of August, 2005, rounding each factor to the nearest \$10. Estimate the cost of the proposal, compared to current law, at \$10.3 million in 2007-08 and \$16.1 million in 2008-09, which would represent increases of \$6.3 million in 2007-08 and \$8.1 million in 2008-09 compared to the original estimates in the bill.

ALT 1	Change to Bill Funding	Change to Base Funding
GPR	\$14,400,000	\$26,400,000

2. Modify the Governor's recommendation by adjusting the credit formula factors by the CPI only for those who are 65, or older. This would increase the estimated cost of the credit, compared to current law, by \$4.0 million in 2007-08 and \$6.4 million in 2008-09 (compared to the original estimates in the bill, there would be no change in 2007-08, and a decrease in the estimated cost of the credit of \$1.6 million in 2008-09).

ALT 2	Change to Bill Funding	Change to Base Funding
GPR	-\$1,600,000	\$10,400,000

3. Increase the per dependent income deduction from \$250 to \$1,000, beginning with tax year 2007. This would increase the estimated cost of the credit, compared to current law, by \$3.3 million in 2007-08 and \$3.2 million in 2008-09.

ALT 3	Change to Bill Funding	Change to Base Funding
GPR	\$6,500,000	\$6,500,000

4. Modify the homestead credit formula by approving both Alternatives 2 and 3. This would provide the Governor's revised formula changes for those claimants 65 or older and would increase the household income deduction per dependent to \$1,000. This would increase the estimated cost of the credit, compared to current law, by \$7.3 million in 2007-08 and \$9.6 million in 2008-09 (compared to the original estimates in the bill, this would increase the cost of the credit by \$3.3 million in 2007-08 and \$1.6 million in 2008-09).

ALT 4	Change to Bill Funding	Change to Base Funding
GPR	\$4,900,000	\$16,900,000

5. Delete provision.

ALT 5	Change to Bill Funding	Change to Base Funding
GPR	-\$12,000,000	\$0

Prepared by: Al Runde
Attachment

ATTACHMENT

**Comparison of Current Law with Governor's Revised Recommendation
2007-08**

Current Law Credit

Income	Property Taxes										
	<u>\$700</u>	<u>\$800</u>	<u>\$900</u>	<u>\$1,000</u>	<u>\$1,100</u>	<u>\$1,200</u>	<u>\$1,300</u>	<u>\$1,450</u>	<u>\$1,650</u>	<u>\$1,800</u>	<u>\$2,000</u>
\$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

Proposed Expansion

Income	Property Taxes										
	<u>\$700</u>	<u>\$800</u>	<u>\$900</u>	<u>\$1,000</u>	<u>\$1,100</u>	<u>\$1,200</u>	<u>\$1,300</u>	<u>\$1,450</u>	<u>\$1,650</u>	<u>\$1,800</u>	<u>\$2,000</u>
\$0	\$560	\$640	\$720	\$800	\$880	\$960	\$1,040	\$1,160	\$1,208	\$1,208	\$1,208
8,000	560	640	720	800	880	960	1,040	1,160	1,208	1,208	1,208
10,000	440	520	600	680	760	840	920	1,040	1,088	1,088	1,088
12,000	300	380	460	540	620	700	780	900	948	948	948
14,000	159	239	319	399	479	559	639	759	807	807	807
16,000	19	98	178	258	338	418	498	618	666	666	666
18,000	0	0	38	118	198	278	358	478	526	526	526
20,000	0	0	0	0	57	137	217	337	385	385	385
22,000	0	0	0	0	0	0	77	197	245	245	245
24,000	0	0	0	0	0	0	0	56	104	104	104

Proposed Expansion -- Change to Current Law

Income	Property Taxes										
	<u>\$700</u>	<u>\$800</u>	<u>\$900</u>	<u>\$1,000</u>	<u>\$1,100</u>	<u>\$1,200</u>	<u>\$1,300</u>	<u>\$1,450</u>	<u>\$1,650</u>	<u>\$1,800</u>	<u>\$2,000</u>
\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$48	\$48	\$48
8,000	0	0	0	0	0	0	0	0	48	48	48
10,000	21	21	21	21	21	21	21	21	69	69	69
12,000	21	21	21	21	21	21	21	21	69	69	69
14,000	21	21	21	21	21	21	21	21	69	69	69
16,000	19	21	21	21	21	21	21	21	69	69	69
18,000	0	0	21	21	21	21	21	21	69	69	69
20,000	0	0	0	0	21	21	21	21	69	69	69
22,000	0	0	0	0	0	0	21	21	69	69	69
24,000	0	0	0	0	0	0	0	21	69	69	69

ATTACHMENT (continued)

**Comparison of Current Law with Governor's Revised Recommendation
2008-09**

Current Law Credit

<u>Income</u>	<u>Property Taxes</u>										
	<u>\$700</u>	<u>\$800</u>	<u>\$900</u>	<u>\$1,000</u>	<u>\$1,100</u>	<u>\$1,200</u>	<u>\$1,300</u>	<u>\$1,450</u>	<u>\$1,650</u>	<u>\$1,800</u>	<u>\$2,000</u>
\$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
26,000	0	0	0	0	0	0	0	0	0	0	0

Proposed Expansion

<u>Income</u>	<u>Property Taxes</u>										
	<u>\$700</u>	<u>\$800</u>	<u>\$900</u>	<u>\$1,000</u>	<u>\$1,100</u>	<u>\$1,200</u>	<u>\$1,300</u>	<u>\$1,450</u>	<u>\$1,650</u>	<u>\$1,800</u>	<u>\$2,000</u>
\$0	\$560	\$640	\$720	\$800	\$880	\$960	\$1,040	\$1,160	\$1,232	\$1,232	\$1,232
8,000	560	640	720	800	880	960	1,040	1,160	1,232	1,232	1,232
10,000	453	533	613	693	773	853	933	1,053	1,125	1,125	1,125
12,000	313	393	473	553	633	713	793	913	985	985	985
14,000	172	252	332	412	492	572	652	772	844	844	844
16,000	32	112	192	272	352	432	512	632	704	704	704
18,000	0	0	51	131	211	291	371	491	563	563	563
20,000	0	0	0	0	70	150	230	350	422	422	422
22,000	0	0	0	0	0	10	90	210	282	282	282
24,000	0	0	0	0	0	0	0	69	141	141	141
26,000	0	0	0	0	0	0	0	0	10	10	10

Proposed Expansion -- Change to Current Law

<u>Income</u>	<u>Property Taxes</u>										
	<u>\$700</u>	<u>\$800</u>	<u>\$900</u>	<u>\$1,000</u>	<u>\$1,100</u>	<u>\$1,200</u>	<u>\$1,300</u>	<u>\$1,450</u>	<u>\$1,650</u>	<u>\$1,800</u>	<u>\$2,000</u>
\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$72	\$72	\$72
8,000	0	0	0	0	0	0	0	0	72	72	72
10,000	34	34	34	34	34	34	34	34	106	106	106
12,000	34	34	34	34	34	34	34	34	106	106	106
14,000	34	34	34	34	34	34	34	34	106	106	106
16,000	32	34	34	34	34	34	34	34	106	106	106
18,000	0	0	34	34	34	34	34	34	106	106	106
20,000	0	0	0	0	34	34	34	34	106	106	106
22,000	0	0	0	0	0	10	34	34	106	106	106
24,000	0	0	0	0	0	0	0	34	106	106	106
26,000	0	0	0	0	0	0	0	0	10	10	10