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Veterans and Surviving Spouses Property Tax Credit (General Fund Taxes -- Income and Franchise Taxes)

[LFB 2013-15 Budget Summary: Page 172, #7]

CURRENT LAW

Wisconsin provides a refundable credit against the individual income tax for property taxes paid by certain veterans and unremarried surviving spouses of veterans. The tax credit is equal to the real and personal property taxes paid on a principal dwelling by an eligible veteran or by an eligible unremarried surviving spouse. Through the credit, the state pays the entire property tax bill of each eligible claimant. The credit is refundable, so it is treated as an expenditure in the state budget. For refundable credits, credit amounts are first used to offset claimants' income tax liabilities, but any credits in excess of liabilities are paid directly to claimants. Individuals claiming the credit cannot also claim the nonrefundable property tax/rent credit or the refundable homestead tax credit. The Department of Revenue (DOR) administers the credit based, in part, on eligibility criteria established by the U.S. Department of Veterans Affairs (U.S. DVA).

GOVERNOR

Provide increases of $4,040,000 in 2013-14 and $14,840,000 in 2014-15 for the refundable veterans and surviving spouses property tax credit to reflect current law re-estimates ($4,040,000 in 2013-14 and $5,340,000 in 2014-15) and proposed changes to the credit's eligibility criteria ($9,500,000 in 2014-15). With these adjustments, base level funding of $20,000,000 would increase to an estimated $24,040,000 in 2013-14 and $34,840,000 in 2014-15. The administration estimates that the eligibility expansion would cause individual income tax collections to increase by $930,000 in 2014-15 due to fewer individuals claiming the property tax/rent credit.

The bill would expand the credit to include unremarried surviving spouses of individuals, when the Department of Veterans Affairs has verified that the individual has met the following criteria: (a) the individual had served on active duty under honorable conditions in the U.S. armed services or in forces incorporated as part of the U.S. armed forces; (b) the individual was a resident of Wisconsin at the time of entry into that active service or had been a resident of Wisconsin for any consecutive five-year period after entry into that active duty service; (c) the individual was a resident of Wisconsin at the time of death; and (d) following the individual's service-related death, the individual's spouse began to receive, and continues to receive, dependency and indemnity compensation as defined under federal law. The proposed eligibility modification would first apply for taxable years beginning on January 1, 2014.

DISCUSSION POINTS

1. The veterans and surviving spouses property tax credit was created by 2005 Wisconsin Act 25 and expanded by 2005 Wisconsin Act 72 and 2007 Wisconsin Act 20. Under current eligibility criteria, the credit may be claimed by eligible veterans and unremarried surviving spouses of eligible veterans. An eligible veteran is defined as a person who: (a) served on active duty in the U.S. armed forces; (b) was a resident of this state at the time of entry into that service or had been a Wisconsin resident for any consecutive five-year period after entry; (c) is currently a resident of the state for purposes of receiving veterans benefits; and (d) has a service-connected disability of 100% or a 100% disability rating based on individual employability.

2. An eligible unremarried surviving spouse includes persons meeting any of three criteria relative to the deceased spouse: (a) the spouse died while on active duty in the U.S. armed forces, was a Wisconsin resident at the time of entry into service or for any subsequent, consecutive five-year period, and was a Wisconsin resident at the time of death; (b) the spouse served on active duty in the U.S. armed forces, was a Wisconsin resident at the time of entry into active service or for any subsequent, consecutive five-year period, was a resident of this state at the time of death, and had a service-connected disability of 100% or a 100% disability rating based on individual employability; or (c) the person served in the National Guard or U.S. armed forces reserves, was a Wisconsin resident at the time of entry into active service or for any subsequent, consecutive five-year period, and died in the line of duty while on active or inactive duty while a Wisconsin resident.

3. Assembly Bill 40 would extend the credit to unremarried surviving spouses of veterans whose death was service-connected and who are receiving death and indemnity compensation. According to the U.S. DVA, dependency and indemnity compensation "is a tax free monetary benefit paid to eligible survivors of military Servicemembers who died in the line of duty or eligible survivors of Veterans whose death resulted from a service-related injury or disease." For spouses of veterans whose deaths occurred after January 1, 1993, the current basic monthly rate is $1,215.

4. Under current law, spouses are eligible for the credit if they are married to a service member who died while on active duty, assuming the residency requirements are met. Therefore, AB 40 would extend the credit to individuals whose spouse died after active duty. Even though the death of the spouse was the result of a service-related injury or disease, the injury or disease did not

cause a disability that met the disability rating threshold that is a condition for receiving the credit under current law provisions.

5. In both tax year 2005 and 2006, total claims of less than $1 million were received by fewer than 500 claimants. After these levels were surpassed in tax years 2007 and 2008, the number of claimants and amount of claims rose dramatically due to the Act 20 changes that took effect in tax year 2009. Table 1 displays these amounts for the most recent five tax years.

TABLE 1

Claimants, Claims, and Average Claims for the Veterans and Surviving Spouses Property Tax Credit, Tax Years 2007 through 2011

Tax Year	Number of Claimants	Percent Change	Amount of Claims	Percent Change	Average Claim	Percent Change
2007	458		$1,345,822		$2,938	
2008	577	26.0%	1,713,587	27.3%	2,970	1.1%
2009	3,665	535.2	10,921,315	537.3	2,980	0.3
2010	5,047	37.7	14,893,638	36.4	2,951	-1.0
2011	5,892	16.7	17,257,777	15.9	2,929	-0.7

6. The tax year increases displayed in Table 1 are mirrored in the totals by state fiscal year, as shown in Table 2. For the five most recent years, tax credit expenditures have grown by $18.4 million, from $1.5 million in 2007-08 to $19.9 million in 2011-12. For 2012-13, claims have been higher in some months and lower in other months, in comparison to the same period in 2011-12. Through March, 2013, claims are 8.0% higher than through March, 2012. In January, 2013, this office re-estimated 2012-13 credits at $21.0 million, which represents a 5.3% increase relative to 2011-12.

TABLE 2

Veterans and Surviving Spouses Property Tax Credit, Funding by Fiscal Year

Fiscal Year	Amount of Claims	Percent Change
2007-08	$1,545,973	
2008-09	2,031,884	31.4%
2009-10	9,602,860	372.6
2010-11	18,225,354	89.8
2011-12	19,939,549	9.4

7. Based on this office's January revision for 2012-13 and more recent data regarding tax credit claims, credit amounts under current law are re-estimated at $23.0 million in 2013-14 and $24.4 million in 2014-15. These amounts represent year-over-year increases of 9.5% and 4.3%,

respectively. Relative to the bill, these re-estimates would lower expenditures by $1,040,000 in 2013-14 and $940,000 in 2014-15, or by $1,980,000 for the biennium (Alternative 1).

8. The proposed change to the eligibility requirements would increase tax credit expenditures by nearly 40%, or by $9.5 million beginning in tax year 2014. The administration estimates that the proposal would result in slightly over 3,000 additional claimants receiving credits of about $3,100 each. Given the rapid increase in the cost of the program in prior years, there may be a concern about increasing the cost of the credit at this time. If so, the Governor's proposal to expand the credit could be removed from the bill, reducing the bill's GPR expenditures by $9.5 million in 2014-15. In addition, the state would not receive the estimated $930,000 in additional tax collections in 2014-15, reflected in AB 40. These collections result from the newly eligible credit claimants being prohibited from claiming the property tax/rent credit (PTRC). The PTRC is a non-refundable credit, so changes to it are reflected as changes in tax revenues. As noted above, refundable credits are reflected as expenditures. This option is presented as Alternative 4, below.

9. Another way to address concerns over the increasing cost of the program would be to impose limits to the credit. To receive the credit, there is no means test, and there is no cap on the amount of each claimant's property taxes that are refunded. The property tax/rent credit is based on the first $2,500 in property taxes on the claimant's residence, and the homestead tax credit is based on up to $1,460 in property taxes. A means test is employed to limit eligibility for some state tax credits, but not all credits employ a means test. For example, individuals with a household income in excess of $24,680 are not eligible to receive the homestead tax credit.

10. Based on aggregate statistics compiled by DOR for tax year 2011, there were 129 tax credit recipients with adjusted gross incomes of $100,000 or more, and they received over $600,000 in credits. The average credit for these recipients was $4,942, or 168.7% of the statewide average of $2,929. These individuals comprised 2.2% of the total number of claimants and received 3.7% of the total credits. Among those claimants, 47 had incomes over $150,000, and they received tax credits totaling almost $300,000. They represent 0.8% of all claimants and 1.7% of total credits. Their average credit of $6,290 was 214.7% of the average for all claimants.

11. One way to reduce the cost of the credit would be to limit the amount of property taxes refunded to each claimant. By setting the limit at $2,500, the same level used for the property tax/rent credit, funding for the credit could be reduced by an estimated $6.9 million in 2013-14 and $10.2 million in 2014-15, on a current law basis. This option is presented as Alternatives 2.a. and 2.b., below. Alternative 2.b. would also remove the proposed expansion of the program from the bill.

12. Another way to reduce the cost of the credit would be to incorporate a means test as a condition for receiving the credit. To avoid a "cliff" effect, tax provisions often utilize a phase-out mechanism based on the taxpayer's income. Under such a mechanism, the tax credit could be based on up to $2,500 in property taxes and would phase down to $0 based on the claimant's Wisconsin adjusted gross income. The phase-out could occur between $75,000 and $150,000 for married-joint filers, $60,000 to $120,000 for head-of-household filers, $50,000 to $100,000 for single filers, and $37,500 to $75,000 for married-separate filers. Under this structure, funding for the credit could be reduced by an estimated $7.6 million in 2013-14 and $11.2 million in 2014-15. This option is

presented as Alternatives 3.a. and 3.b., below. Alternative 3.b. would also remove the proposed expansion of the program from the bill.

13. Economic theory offers several principles that can be used to evaluate tax policies, such as reliability, neutrality, accountability, and equity. Horizontal equity is achieved when taxpayers with similar economic characteristics bear similar tax burdens. The veterans and surviving spouses tax credit violates this principle by paying the property tax bills of eligible claimants without regard to their economic characteristics. Other state tax relief programs are either extended equally to all taxpayers, such as the PTRC, or are means-tested and limited to taxpayers in similar economic circumstances, such as the homestead tax credit. The veterans and surviving spouses tax credit possesses no similar characteristics and, instead, provides a substantial tax benefit to a select group of taxpayers without regard to their level of income. Programs to assist veterans should be administered by the Department of Veterans Affairs, as many are, rather than through the state tax code. Relative to the bill, the repeal of the tax credit would reduce estimated GPR expenditures by $58,880,000 and state tax collections by $930,000 in the 2013-15 biennium. This is presented as Alternative 5.

ALTERNATIVES

1. Approve the Governor's proposal to expand eligibility for the credit, and reduce estimated expenditures for the credit to reflect current participation levels by $1,040,000 in 2013-14 and $940,000 in 2014-15. Total funding for the credit would be $23,000,000 in 2013-14 and $33,900,000 in 2014-15.

ALT 1	**Change to Bill** Funding
GPR	- $1,980,000

2. Modify the veterans and surviving spouses property tax credit by limiting the amount of property taxes that can be reimbursed for each claimant to $2,500 annually. In addition:

a. Approve the Governor's proposal to expand eligibility for the credit, and reestimate expenditures for the credit to reflect current participation levels. Reduce estimated expenditures by $7,940,000 in 2013-14 ($6,900,000 to reflect the proposed limitation and $1,040,000 to reflect current participation levels) and by $11,140,000 in 2014-15 ($10,200,000 to reflect the proposed limitation and $940,000 to reflect current participation levels). Total funding for the credit would be $16,100,000 in 2013-14 and $23,700,000 in 2014-15; or

ALT 2a	**Change to Bill** Funding
GPR	- $19,080,000

b. Delete the Governor's proposal to expand eligibility for the credit, and reestimate expenditures for the credit to reflect current participation levels. Reduce estimated expenditures by $7,940,000 in 2013-14 ($6,900,000 to reflect the proposed limitation and $1,040,000 to reflect current participation levels) and by $17,740,000 in 2014-15 ($7,300,000 to reflect the proposed limitation, $9,500,000 to reflect eliminating the proposed eligibility expansion, and $940,000 to reflect current participation levels). Total funding for the credit would be $16,100,000 in 2013-14 and $17,100,000 in 2014-15. Reduce individual income tax collections by an estimated $930,000 in 2014-15.

ALT 2b	**Change to Bill**	
	Revenue	Funding
GPR-Tax	- $930,000	
GPR		- $25,680,000

3. Modify the veterans and surviving spouses property tax credit by limiting the amount of property taxes that can be reimbursed for each claimant to $2,500 annually and creating a phase-out for the program for claimants with a Wisconsin adjusted gross income between $75,000 and $150,000 if filing married-joint, $60,000 to $120,000 if filing head-of-household, $50,000 to $100,000 if filing single, and $37,500 to $75,000 if filing married-separate. In addition:

a. Approve the Governor's proposal to expand eligibility for the credit, and reestimate expenditures for the credit to reflect current participation levels. Reduce estimated expenditures by $8,640,000 in 2013-14 ($7,600,000 to reflect the proposed limitations and $1,040,000 to reflect current participation levels) and by $12,140,000 in 2014-15 ($11,200,000 to reflect the proposed limitations and $940,000 to reflect current participation levels). Total funding for the credit would be $15,400,000 in 2013-14 and $22,700,000 in 2014-15; or

ALT 3a	**Change to Bill**
	Funding
GPR	- $20,780,000

b. Delete the Governor's proposal to expand eligibility for the credit, and reestimate expenditures for the credit to reflect current participation levels. Reduce estimated expenditures by $8,640,000 in 2013-14 ($7,600,000 to reflect the proposed limitations and $1,040,000 to reflect current participation levels) and by $18,540,000 in 2014-15 ($8,100,000 to reflect the proposed limitations, $9,500,000 to reflect eliminating the proposed eligibility expansion, and $940,000 to reflect current participation levels). Total funding for the credit would be $15,400,000 in 2013-14 and $16,300,000 in 2014-15. Reduce individual income tax collections by an estimated $930,000 in 2014-15.

ALT 3b	Change to Bill	
	Revenue	Funding
GPR-Tax	- $930,000	
GPR		- $27,180,000

4. Delete the Governor's proposal to expand eligibility for the credit and reduce estimated expenditures for the program by $9,500,000 in 2014-15. In addition, reduce estimated expenditures for the credit to reflect current participation levels by $1,040,000 in 2013-14 and $940,000 in 2014-15. Relative to the bill, 2014-15 expenditures would be lower by $10,440,000. Total funding for the credit would be $23,000,000 in 2013-14 and $24,400,000 in 2014-15. Reduce individual income tax collections by an estimated $930,000 in 2014-15.

ALT 4	Change to Bill	
	Revenue	Funding
GPR-Tax	- $930,000	
GPR		- $11,480,000

5. Delete the Governor's recommendation to expand eligibility for the credit and, instead, repeal the veterans and surviving spouses property tax credit effective for tax years beginning after December 31, 2012. Reduce estimated expenditures for the program by $24,040,000 in 2013-14 and $34,840,000 in 2014-15. Reduce individual income tax collections by an estimated $930,000 in 2014-15.

ALT 5	Change to Bill	
	Revenue	Funding
GPR-Tax	- $930,000	
GPR		- $58,880,000

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