State of Wisconsin • DEPARTMENT OF REVENUE

DIVISION OF RESEARCH AND POLICY • 2135 RIMROCK ROAD, 6-73 • P.O. BOX 8933 • MADISON, WISCONSIN 53708-8933
PHONE (608) 266-2700 • FAX (608) 266-8704
• http://www.dor.state.wi.us

M E M O R A N D U M

November 4, 2004

TO: Mary Matthias
Legislative Council

FROM: Audra Brennan
Department of Revenue

SUBJECT: Information for Sepcial Committee on Property Tax Exemptions for Residential Property

This memorandum provides three pieces of information that may be of interest to the Legislative Council's Special Committee on Property Tax Exemptions for Residential Property:

- The estimated property tax shift to taxable property that occurs because of the exemption for retirement homes, which we estimate to be $16.2 million. This is in addition to the estimated property tax shift of $17.7 million for housing other than nursing homes and retirement homes that we provided to the committee at its first meeting. In addition, we also provide information on the estimated value of exempt nursing homes, retirement homes and other housing every other year from 1995/96 to 2001/02.

- The estimated increase in Homestead Tax Credit spending from raising the income ceiling for the credit and maximum eligible property tax to the amounts they would have been had they ceiling been indexed for inflation after 2001. Raising the income ceiling would increase Homestead spending by an estimated $12 million in FY06 and $13.5 million in FY07; raising both the income ceiling and the maximum eligible property tax to amounts would increase spending by $13.6 million in FY06 and $15.5 million in FY07.

- A description of the Internal Revenue Service's rationale for providing a federal income tax exemption for non-profit retirement homes, and the qualifications that must be satisfied in order to receive that exemption.

Property Tax Exemption for Retirement Homes

We estimated the amount of property tax shifted from retirement homes to other property due to the exemption under sec. 70.11 (4) using the same methodology used to estimate the shift for other exempt housing in the fiscal estimate for Senate Bill 512 (2003 Wisconsin Act 195).

We assume the total value for exempt retirement homes equals the amount estimated from exemption summary reports filed in 2002 by owners of exempt retirement homes with municipalities. This amount was $790 million. Applying the net statewide average tax rate for

2002/03 of $20.55 per $1,000 of equalized value yields an estimate of $16.2 million ($790 million X 0.02055) shifted to other property taxpayers by the exemption in 2002/03.

Some committee members have expressed an interest in how this tax shift has changed over time. Based on estimates of exempt value reported in the biennial *Summary of Tax Exemption Devices* beginning in 1997 and using the net statewide average tax rate for the levy year, we estimate the following property tax shift:

	Property Tax Shift from Exemption For Residential Housing ($ million)			
Levy Year	Nursing Homes	Retirement Homes	Other Housing	Total
1995/96	$21.7	$9.8	$15.5	$47.0
1997/98	$32.7	$18.6	$11.6	$63.0
1998/2000	$37.9	$17.0	$10.6	$65.5
2001/02	$20.4	$16.2	$17.7	$54.4

The trend in the data is not consistent for any of the three types of housing, probably because of the nature of the way the data are collected. Every other year, owners of exempt property estimate the value of that property to the municipality in which the property is located. The municipality submits aggregated information to the Department of Revenue (DOR) for use in the *Summary of Tax Exemption Devices*, which is published as one of the governor's budget documents every other year.

One problem with the data is the potential for underreporting the value of exempt property. One reason for the problem could be limited knowledge. Owners of some exempt property may not have good information on what the market value of their property is. Further, exact values are not reported to DOR; instead, municipalities submit reports showing the number of parcels in certain value categories.

Another problem is that reporting by municipalities is incomplete. As a result, DOR has to estimate a statewide total value on the basis of the reports that have been filed. The extent of incomplete reporting is increasing.

More detailed data are shown in an addendum to this memo. The data for 2003/04 will be available as part of our biennial *Summary of Tax Exemptions Devices* that will be published in February 2005.

Increasing the Homestead Tax Credit Income Ceiling and Maximum Property Tax

At the committee's initial meeting, there was some discussion about increasing property tax relief through the Homestead Credit. This can be achieved by raising the income ceiling and maximum eligible property tax for purposes of the credit.

The income ceiling for the Homestead Tax Credit has been $24,500 since 2001. Had the ceiling been indexed for inflation since that year, the income ceiling would be $27,430 for claims filed in 2006 and $27,800 for claims filed in 2007. Raising the ceilings to these amounts would increase Homestead credit expenditures by $12 million in FY06 and $13.5 million in FY07.

The maximum eligible property tax, or rent constituting property tax, that may be used in calculating the Homestead credit is $1,450; it has been at that level since 1990. If this maximum property tax had been indexed for inflation since 2001, it would be $1,620 for claims filed in 2006 and $1,650 for claims filed in 2007. Raising both the income ceiling and the maximum eligible property tax would increase Homestead credit expenditures by $13.6 million in 2006 and $15.5 million in 2007.

In both of these estimates, it was assumed that the income threshold, at which the credit would begin to phase out, would be $8,000. That threshold has been in place since 1990.

Internal Revenue Service Rulings Regarding Homes for the Aged

At the initial committee meeting, a member asked for information on the criteria the Internal Revenue Service (IRS) uses in granting federal income tax-exempt status to retirement homes. In Revenue Ruling 72-124, the IRS laid out its rationale for granting an income tax exemption under section 501 (c)3 of the Internal Revenue Code for homes for the aged and laid out the activities an entity must meet to qualify for that exemption.

In the ruling, the IRS determined that, for purposes of a federal income tax exemption, addressing special needs of the elderly could be considered serving a charitable purpose, even though there is no financial assistance or other direct relief of poverty. These include the needs for suitable housing, physical and mental health care, civic, cultural and recreational activities, and an environment conducive to the elderly's dignity and independence.

Ruling 72-124 indicated that an organization serving the needs of elderly persons for housing, health care and financial security will qualify for a tax-exempt charitable organization if it satisfies the other criteria of federal law applicable to all charitable organizations. An organization satisfies the housing need by providing residential facilities that meet the physical, emotional, recreational, social, religious and other needs of the aged. It satisfies the need for health care by providing such care directly or arranging with other organizations for its provision.

As to the need for financial security, or protection against the financial risks associated with advanced age, the IRS identified two conditions. The first is a commitment to maintaining in residence any person who becomes unable to pay regular charges. The IRS indicated that an organization required by its financing arrangement with a state or federal government to devote its facilities to low- and moderate-income elderly and that recovers its operating costs from such residents may satisfy this condition.

The second condition is provision of services at the lowest feasible cost. In determining whether this condition is met, all entrance, founder's and monthly fees must be considered in relation to all expenses, including debt retirement, maintenance of reserves sufficient to insure life care and reserves for limited expansion. Ruling 72-124 indicated that renting a portion of the facilities at rates below the cost of providing services to persons of limited means provides evidence that an organization is attempting to satisfy the needs for financial security, providing it fulfills the guaranteed care condition.

Other Revenue Rulings that provide additional discussion include Ruling 61-72, which considers the treatment of an organization providing services to persons of limited means at below-cost rates, and Ruling 79-18, which further discusses the guaranteed care and lowest feasible conditions.

I hope this information is useful to the committee. Please let me know if you have additional questions.

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ADDENDUM
Amount of Value of Exempt Housing, Selected Years, 1995/96 – 2001/02
(Amounts in $ millions)

Levy Year	Reported Exempt Values	Net Statewide Average Tax Rate	State Total Equalized Value	Exempt Value As % Of Equalized Value	Property Tax Shift
Nursing Homes					
1995/1996	$958	0.02262	$201,538	0.48%	$21.7
19971998	$1,481	0.02211	$233,074	0.64%	$32.7
1999/2000	$1,770	0.02142	$286,321	0.62%	$37.9
2001/2002	$993	0.02055	$335,326	0.30%	$20.4
Retirement Homes					
1995/1996	$435	0.02262	$201,538	0.22%	$9.8
19971998	$843	0.02211	$233,074	0.36%	$18.6
1999/2000	$793	0.02142	$286,321	0.28%	$17.0
2001/2002	$790	0.02055	$335,326	0.24%	$16.2
Other Housing					
1995/1996	$687	0.02262	$201,538	0.34%	$15.5
19971998	$526	0.02211	$233,074	0.23%	$11.6
1999/2000	$496	0.02142	$286,321	0.17%	$10.6
2001/2002	$862	0.02055	$335,326	0.26%	$17.7
Total Housing					
1995/1996	$2,080	0.02262	$201,538	1.03%	$47.0
19971998	$2,850	0.02211	$233,074	1.22%	$63.0
1999/2000	$3,059	0.02142	$286,321	1.07%	$65.5
2001/2002	$2,645	0.02055	$335,326	0.79%	$54.4