Questions and Answers About the New Property Tax Relief and the Local Income Tax Options

June 20, 2007

Larry DeBoer did a video presentation about property taxes and the new local income tax options on Monday, June 18, 2007. Viewers at the forty county sites were invited to send questions. Here are the questions (with the names of the questioners removed), and the answers.

**Homestead Credit Rebate, 2007**

*Do I correctly understand that the average rate, payable in summer and fall, WILL increase 24% and be payable, but 15.3% of that will be reimbursed to us in December? Any guarantee that will actually be paid? What about homes that are sold between now and then?*

Yes, that’s right, the statewide average 24% homeowner property tax increase will be reduced to around 8% because of the rebates. So homeowners will pay the higher taxes during the year’s two billings, then receive the rebate to compensate for about 2/3’s of the increase. These are statewide averages, so the results for each county, tax district and taxpayer can differ.

House Bill 1835 says the race track casino (racino) payments are to be placed in the property tax reduction trust fund. The budget bill, HB 1001, appropriates $300 million from this fund for property tax relief in 2007. I can’t see where it says what happens if the property tax reduction trust fund is empty, but I’d guess the appropriation doesn’t get made. The state budget is not in a position to absorb $300 million in added spending without an added revenue source. It would be a shock if the licenses didn’t sell—Indiana casinos have proved very lucrative—but I suppose it could happen.

You’re right that there’s a problem with homes that are sold between the time that the property taxes are paid and the rebates are mailed. I don’t know that there’s been a rule made on how to handle this. I did see an auditor/treasurer recommendation that the rebate checks should be made out to the person who paid the tax, and mailed to the person’s old address. Either the post office would forward the letter, or return it to the treasurer with a forwarding address. The treasurer would have to re-send it. If the original owner can’t be found, the county would hold the check for a while as a kind of unclaimed property, which the taxpayer could claim, then return it to the state.

*Re: Homestead Credit Rebate --15.3% - Is this an accurate estimate figured by the DLGF or just a “best guess”?*

The 15.3% figure is the estimated decrease in the statewide average homeowner tax bill. It comes from an elaborate model of the property tax maintained by the Legislative Services Agency. The model is based on parcel-by-parcel assessment data acquired from the counties.
It’s the best guess that can be made with the data available. We’ll only know if it’s an accurate estimate after all counties complete their tax billing, and the data are added up statewide.

Note, though, that it’s a statewide average, so the actual effects will vary by county, tax district and taxpayer.

*Are out of state residents who own homes in Indiana eligible for homestead credit rebates?*

No. Homestead credits are restricted to owner-occupied primary residences. An out-of-state resident must have his/her primary residence elsewhere, so the Indiana residence must be a second home. It would not be eligible for the credit.

*Will rebates be taxable to homeowners as income?*

*In relation to end of the year rebates on property taxes. --- Will homeowners be taxed as income on this rebate?*

I don’t think there’s an official word on this yet. I saw a recommendation by some auditors and treasurers that the rebate checks include the phrase “The IRS may consider this refund income.”

I’m no tax attorney, but here’s what makes sense to me. If the rebates come before the end of the year, and are treated as a reduction in 2007 property tax payments, then no, they’re not income. If the rebates come after the first of the year, and are not treated as a reduction in 2007 property tax payments, then yes, they are income. If taxpayers deduct their 2007 property tax payments as billed, not counting the rebate, then the rebate is effectively additional income. But if they deduct their 2007 property tax payments less the rebate, then the rebate is not new income.

*What is the estimated cost of rebate administration to local governments?*

I don’t think anyone has done statewide estimates. At 41 cents postage, mailings to more than 1.6 million homesteads would cost about $650,000 dollars, but that doesn’t count other mailing costs, printing, and especially the cost of time by employees of the auditor and treasurer’s offices. The county auditors and treasurers may have a better idea of costs for each county—it’s essentially a reverse tax billing, except the bills go only to homesteads.
General Administration of Local Income Taxes

Who puts the LOIT in place? County, city, town and does it apply to all civil units?

In counties with the CAGIT local income tax, the county council makes the decision. In counties with the COIT local income tax, the COIT council makes the decision. In counties with neither tax, either body can act to adopt. These are the counties with the EDIT tax only, and the two counties without any income tax.

The COIT council is made up of the fiscal bodies of the county, cities and towns in a county. That’s the county council, city council and town council or town board. Votes are divided based on shares in total population, with the county’s share equal to the share living outside cities or towns. In most rural counties the county council has the majority of the COIT council votes, so they make the decision anyway. In many of the big counties a single city has a majority of votes, so the city council decides. In some counties no single unit has a majority, so a combination of units must vote yes to adopt any of the income taxes.

The levy freeze income tax applies to all civil units—that’s counties, townships, cities and towns, library districts and other special districts. It doesn’t apply to school corporations. All those units will have their operating levies frozen and will receive an equivalent amount from income tax revenues.

Revenue from the quarter-percent public safety income tax would be distributed among the county, cities and towns.

Our county adopted a .25 CAGIT above max to fund a correctional facility - Does the new legislation allow us a full 1% increase?

In case of Boone County, what rate can they increase each year since they are at 2% or will they be held at the current rate?

House Bill 1478 is full of statements that the new local income taxes are independent of anything else the county has done or is allowed to do with local income taxes. For example, section 66 of the bill (6-3.5-1.1-24(d)) says “a tax rate under this section is in addition to any other tax rates imposed under this chapter and does not affect the purposes for which other tax revenue under this chapter may be used.” So, yes, all counties can use the full 1% increase.

What is the impact of the optional income taxes on entities located in TIF districts?

That’s a very good question. TIF revenues are calculated by multiplying the incremental increase in assessed value over a base amount by the total property tax rate in the taxing district. If the tax rate falls, TIF revenues could be reduced.

House Bill 1478 doesn’t appear to address TIF districts, perhaps because it probably won’t have much effect, at least at first. The local income tax for property tax relief
affects property tax payments, but doesn’t change property tax rates. That’s because the tax relief is distributed as credits, after the tax rates have been calculated. TIF revenue depends on the rates, so it wouldn’t be affected.

The local income tax for the levy freeze, though, could reduce rates. This will occur gradually as the frozen levy is divided by ever increasing assessed value. Remember, though, that school and debt service levies aren’t included, so the rate reduction in any one year will be quite small, if rates are reduced at all. Over many years rates probably would decline, though, and the legislature may have to address the problem.

Indiana code 6-1.1-21.2 says that a shortfall in TIF revenues can be made up by increasing the tax rate in the TIF district. I don’t think it applies to local income taxes as its written now, but I suspect something like this would be.

**Levy Freeze Local Income Tax**

*What percentage can the Council increase their levy for 2007?*

The 6-year average increase in non-farm personal income for Indiana, 2000-2006, is 3.7%. The growth quotient on the controlled levy will probably be near that figure.

*You indicated a yearly decision on a frozen levy. However, I interpret that ‘1478’ states a local ordinance that never allows a return to property tax levy.*

The bill is confusing, but I’m sure of this point from discussions with staffers in the State House.

The bill says that when first adopted, the local income tax must be set for two years. After that, it says the tax rate “continues in effect in later years unless the tax rate is increased under this section” (Section 66 of the HB 1478). If the civil operating tax levy were frozen permanently, the local income tax rate would have to increase each year to cover the levy increase—there could be no option to hold the rate fixed. But the bill says the rate will remain fixed, unless the county acts to raise it. If the county doesn’t act, the implication is that the property tax will fund the levy increase.

The county can never return to the property tax to fund a particular year’s increase in the levy once it has been funded by the income tax. For example, if a county funds its million-dollar increase in the civil operating levy with an income tax in 2008, that million dollars will be funded by that income tax rate forever. The income tax rate can’t be reduced or rescinded. But after that (after the two-year period when first adopted) the county must decide each year whether to fund annual levy increases with income or property taxes.
If enacted at 1% the income tax collected will be approx .7% greater than the first year needed. This seems that the stabilization fund will be excessively funded. Your comments please.

The 1% rate is the upper limit for the levy freeze income tax. No county will be able to adopt at that rate in the first year, though. The Department of Local Government Finance will set the rates that must be used if the levy freeze income tax is adopted. Counties will be notified of these rates by July 1.

Still, I think you’re right that the stabilization fund will be excessively funded. Rounding up to the next tenth will increase the stabilization fund. So will the annual increases in county taxable income multiplied by the fixed income tax rate.

I also expect that use of the stabilization fund will be rare. It requires either a shortfall of income tax revenue below the levy increase, or a drop in income tax revenue from one year to the next. The former is made unlikely by the rounding up. The latter happened to statewide revenue only once in the past 17 years. It happened to a lot of counties in the first half of this decade, as a result of the recession and an old method of calculating income tax distributions. The new method should reduce the chances of a repeat.

So, the stabilization fund is likely to accumulate a lot of revenue. I would expect that once this happens the legislature may change the rules on how it’s accumulated, or on how it can be used.

**Property Tax Relief Local Income Tax**

Corporations do not pay COIT – How will this affect overall tax collection for relief on property taxes?

The new local income taxes are individual income taxes, not corporate income taxes. Regular corporations don’t pay these taxes (though any owners and managers who live in the county pay on their income, of course). Small corporations and partnerships do pay the individual income tax.

This means that regular corporations can’t lose from local income tax adoption. If the tax relief income tax revenue is distributed to all taxpayers, corporations receive a property tax cut. If relief is distributed to homeowners only or to homeowners and rental housing owners, corporations don’t receive a property tax cut. But either way, corporate profits are not taxed by the local income tax. Corporations get either a tax break, or are not affected.

General property tax relief would make operating in the county more profitable, so corporations might expand their operations. If so, added employees, wages and salaries would increase local income tax revenue.
The existing local income taxes are also individual income taxes. They don’t tax corporate profits. So the 90 counties that already have local income taxes will know about how much revenue the local income taxes raise, without corporate tax payments.

Public Safety Local Income Tax

Public Safety LOIT: Can income be used for public safety issues at County Highway Departments? Ex: Road signs, Guard rails, Ice abrasives, etc.?

No. The list of public safety uses is pretty specific. You can see the list in section 67 of House Bill 1478. Highway costs aren’t included.

Effects on Local Economies

How do you see these changes (local income tax options) affecting the Indiana foreclosure rate over the next 3 – 5 years?

I suppose people most in danger of foreclosure are those who are “property rich and income poor.” They owe more in mortgage payments, insurance and property tax payments on their homes than their incomes will support. Such homeowners are likely to benefit from the one percent income tax for property tax relief. That’s especially true if the tax relief is distributed to homeowners only as homestead credits. Still, property tax payments are generally a small part of the total house payment. The new income tax options should help rather than hurt, but I’d expect the effect to be small.

Statistics show that our county personal income per capita is lower than surrounding counties - - If we shift from property taxes to income tax, how does that affect us compared to our neighboring counties especially in terms of economic development?

A one percent income tax won’t raise as much relative to your property tax levy as it will in surrounding counties. That means that tax rates in your county won’t fall as much as in surrounding counties. So it’s plausible that surrounding counties will gain an advantage in economic development.

Generally, some counties are income-poor and property-rich, others are income-rich and property-poor. Allowing counties to fund their services with income taxes tends to help the income rich counties. Perhaps we’ll find that those counties will be more likely to adopt income taxes, while the property-rich counties will not.
Abolishing Property Taxes

Is anyone exploring options to abolish property taxes?

Occasionally abolishing the property tax is discussed, and sometimes bills are proposed. The Indiana House voted in favor of such a bill in 2006. It was HB 1001, and it passed 97 to 1. The bill didn’t propose any alternative tax for funding local government. The fiscal note blandly says that it would cost local governments $5.4 billion in revenues. I think the House vote was largely symbolic. The Senate removed that provision before the bill passed.

We’ll know we’re serious about abolishing the property tax when we start addressing the nasty, difficult issues such a move brings up, like “what other taxes will replace it?”, “who will administer the new taxes?” and “how will we renegotiate the debt service agreements with our bond holders?” I haven’t seen any studies like that yet.