

Why Circuit Breakers Make Local Government Policy Decisions Interdependent

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A Homeowner's Tax Bill: Assessed Value and Deductions by 2010

Gross Assessed Value	120,000
Homestead Standard Deduction	45,000
Remainder	75,000
35% Homestead Supplemental Deduction	26,250
Mortgage Deduction	3,000
Taxable Assessed Value	45,750

A Homeowner's Tax Bill: Tax Rate, Circuit Breaker and Tax Bill

Tax Rate	3.00
Gross Tax Bill (rate times taxable AV)	1,373
Circuit Breaker Limits (1% of gross AV)	1,200
Circuit Breaker Credit	173
Net Tax Bill	1,200

If tax rate is 2.00, not 3.00, net tax bill before circuit breaker credit is \$915. That's less than the circuit breaker limit, so credit is zero.

A Homeowner's Tax Bill: Collections and Losses for Local Governments

	Rate	Tax Levied	Circuit Breaker Loss	Tax Collected
County	0.75	343	43	300
City	1.00	458	58	400
School Corporation	0.75	343	43	300
Other Units	0.50	229	29	200
Total	3.00	1,373	173	1,200

Consider what a tax bill for a homeowner might look like in 2010. The home is assessed at \$120,000, which is near the median value of a home in Indiana. Homeowners receive a \$45,000 standard deduction up to 60% of their home's value. This is subtracted from the gross assessed value, leaving \$75,000. The new property tax reform adds a supplemental deduction equal to 35% of this remainder, or \$26,250. Most homeowners also receive the \$3,000 mortgage deduction, which was not changed by the new reforms. The amount of assessed value subject to the property tax would be \$45,750, only 38% of the gross assessed value.

Suppose the property tax rate is relatively high, at \$3.00 per \$100 assessed value (3%). This rate is multiplied by the taxable assessed value, and the result is the gross tax bill, \$1,373. In 2010 the circuit breaker limit for homesteads will be 1% of gross assessed value, which is \$1,200 for this taxpayer. A \$173 circuit breaker credit would be subtracted from the tax bill to bring the net bill down to the \$1,200 limit. Had the rate been \$2.00 per \$100 assessed value, instead of \$3, the gross tax bill would have been \$915. Since this is less than the circuit breaker limit, there would be no circuit breaker credit. Circuit breaker credits are more likely where tax rates are higher.

The \$173 circuit breaker credit is part of the tax bill that taxpayers do not pay, and local governments do not receive. The \$3.00 tax rate is the sum of the tax rates of the jurisdictions in which the property is located. In this example the rate is made up of a \$0.75 county rate, a \$1.00 city rate, a \$0.75 school corporation rate, and a \$0.50 rate for other units like library districts, townships and solid

waste management districts. The revenue lost to the \$173 circuit breaker is divided among these overlapping units of government based on their shares in the total tax rate. The city, for example, has a rate equal to 1/3 of the total rate, and so is assigned 1/3 of the circuit breaker loss. Each unit collects less than its full property tax levy from this taxpayer.

A Homeowner's Tax Bill: Tax Rate, Circuit Breaker and Tax Bill

Tax Rate	3.25
Gross Tax Bill (rate times taxable AV)	1,487
Circuit Breaker Limits (1% of gross AV)	1,200
Circuit Breaker Credit	287
Net Tax Bill	1,200

Now suppose the school corporation's tax rate was \$1.00 instead of \$0.75, so the total tax rate is \$3.25. Multiplied by taxable assessed value, this gives a gross tax bill of \$1,487. But the homeowner's circuit breaker limit is still \$1,200, so the net tax bill can't rise. Instead, the circuit breaker credit rises to \$287.

Suppose School Rate rises to 1.00

A Homeowner's Tax Bill: Collections and Losses for Local Governments

	Rate	Tax Levied	Circuit Breaker Loss	Tax Collected
County	0.75	343	66	277
City	1.00	458	88	369
School Corporation	1.00	458	88	369
Other Units	0.50	229	44	185
Total	3.25	1,487	287	1,200

The \$287 in circuit breaker losses must be divided among the overlapping governments. Again, the losses are allocated based on share in the total tax rate. Because the circuit breaker credit is larger, every unit sees greater revenue losses.

A Homeowner's Tax Bill: Effect on Local Government Tax Collections

	Change in Tax Levied	Change in Tax Collected	Change in Circuit Breaker Loss
County	0	-23	+23
City	0	-31	+31
School Corporation	+114	+69	+45
Other Units	0	-15	+15
Total	+114	0	+114

The county, city and other units did not increase their levies, but see greater circuit breaker losses. Their property tax collections are reduced. The school corporation increased its levy by \$114, but receives only \$69 in added revenue. The same total tax is collected. The rate change merely rearranged the shares of the \$1,200 that each unit receives.

This example shows that any one unit cannot know how much revenue it will receive until it knows the tax rates of units with which it shares taxpayers. The county may receive \$300 from this homeowner, or \$277,

depending on the tax rate charged by the school corporation. Where there are circuit breaker credits, local government budgets are interdependent.

In counties with significant circuit breaker credits, policy changes in one jurisdiction can affect the revenues of others. Here are a few ways in which tax rates, assessments, levies and policy decisions will be interdependent.

Budgets. The school corporation sets its tax rate. So does the city and the county. The sum of those tax rates is what taxpayers pay. If the sum is high enough, taxpayers will be eligible for circuit breaker credits, and revenues will be lost. Losses will be allocated among the local units, based on shares in the tax rate. So: the school corporation's budget decisions affect the revenues received by the city, the city's decision affect the school, both affect the county. Local government officials can't know how much revenue they'll receive, until all units set their budgets and tax rates. *No one can budget until everyone budgets.*

Annexation. When a city/town annexes territory, it adds an extra layer of tax rates to additional taxpayers. Higher tax rates mean more taxpayers will be eligible for circuit breaker credits, and these revenue losses will be divided among the overlapping governments. The school corporations, county and others may lose revenue from city/town annexation.

Bond issues. Debt service tax rates on smaller bond issues are covered by the circuit breaker limits. The higher tax rates from added debt service will reduce the revenues of overlapping governments, and reduce the operating revenues of the government that issued the bond. Larger bond issues are outside the circuit breaker limits, and so will not affect other revenues. These bond issues are subject to referenda. The choice between a small bond issue and a large bond issue matters to overlapping governments (they'll prefer a larger bond issue, since it can't cost them revenue).

Changes in Assessed Values. Changes in assessed values affect tax rates. If tax rates rise, more taxpayers will be eligible for circuit breaker credits, which will be allocated among overlapping units. Every unit in a county shares its taxpayers with the county. If changes in assessed value affect the county's tax rates, they could affect circuit breaker losses for every unit in the county. This means that changes in assessed values even outside a school corporation's or city's borders could affect its revenues, if it changes the county's tax rate.

Assessment Practice. If assessments are too low, and tax rates are higher, circuit breaker limits will be tighter and more taxpayers will be eligible for circuit breaker credits. Under-assessment results in revenue losses. The quality of assessment practice matters for local revenues.