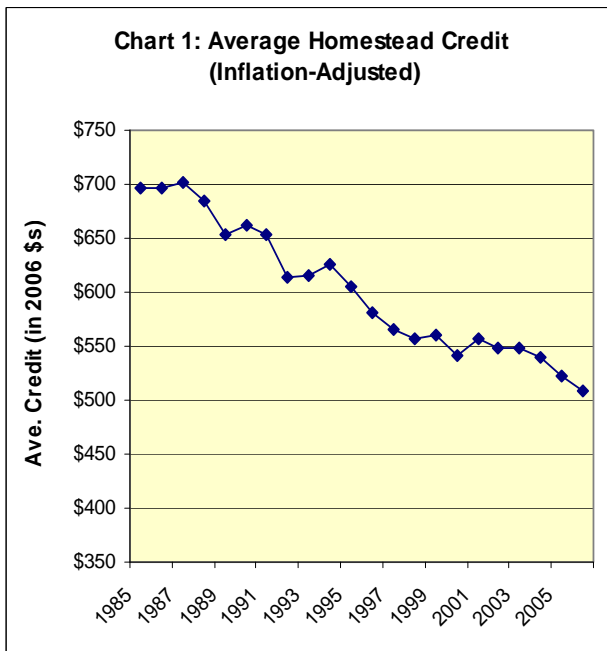


Ending the Erosion of the Homestead Tax Credit

Although the growth in property tax bills has been far lower over the last couple of years, property taxes are still a heavy burden for low-income taxpayers and seniors on fixed incomes. The tax incidence study conducted by the Department of Revenue in 2004 found that the Homestead Tax Credit, which provides relief to homeowners and renters making less than \$24,500 per year, is a critical program in making property taxes less burdensome for low-income households in Wisconsin.

In most respects the Homestead Credit is very well designed. It is a “circuit breaker” credit, which means that it uses a formula that compares an applicant’s property taxes and income, in order to target relief to those who most need it. Because it is a refundable credit, it helps people with too little income to benefit from the nonrefundable property-tax/rent credit. And unlike the lottery credit, the Homestead Credit helps renters as well as homeowners.



The one significant problem with the Homestead Credit is that it is the only major portion of our tax code that is not indexed for inflation. Most components of the formula have not been changed since 1991 (with the exception of the upper income limit which was last increased in tax year 2001).

The failure to adjust the credit for inflation has resulted in a significant reduction in the number of people eligible, a much smaller percentage of taxes offset by the credits, and a large drop in the number of people who meet the income standard for the maximum credit. More specifically, when we took a careful look at the effect of inflation on the Homestead Credit program we found the following:

- The inflation-adjusted value of the maximum credit has declined by \$639 or almost 36 percent since 1985.
- Despite Wisconsin’s growing population, the number of claims is down 25 percent since 1980.
- The real value of the average credit has fallen 27 percent since 1985.
- Inflation-adjusted state spending for the program fell by 46 percent since its peak in 1980.

The table on the next page provides a more detailed analysis of how the current formula compares to the Homestead Credit parameters in 1985, when inflation is taken into account.

Recommendations

At a minimum, the income limit and other formula factors used in calculating the Homestead Credit should be indexed for inflation in future years. In addition, the Governor and Legislature should adjust the formula in the 2007-09 budget to make up at least some of the ground that has been lost to inflation over the last two decades.

In light of the significant increases in property taxes since the formula was changed in 1991, we would optimally like to see all of the formula factors adjusted back to their value at that time. A compromise would be to: a) increase the income eligibility cap to \$28,000, which would roughly adjust it for the inflation since 2001, and b) make up half of the lost value of the other formula factors since 1985. Such a compromise would raise the maximum property tax subject to the credit to \$1,850, the maximum credit to \$1,480 and the income limit for eligibility for the maximum credit to \$11,000.

The Governor’s budget, as introduced, adjusts one part of the Homestead credit formula – the upper income limit. However, a March 19 letter sent by the Governor to the Joint Finance Committee indicates that the bill should be amended to reflect his intent to apply indexing to all of the credit formula, and to take effect in tax year 2007 (FY 2008). The budget includes \$12 million to index the income limit in both years of the biennium, but the net cost increase for the credit is just \$3.1 million because the “cost to continue” under current law goes down each year. The net increase would be 1.0 percent in 2007-08 and 0.6 percent the next year.

Although we would prefer to see a larger change in the credit formula to adjust for the effects of inflation over the last 15 years, we are very pleased that that a proposal has been advanced to change the credit formula prospectively, so it does not continue to be diminished every year by inflation.

Conclusion

The Homestead Tax Credit provides much less property tax relief than it once did because it has been severely eroded by inflation. Although the upper income limit was increased in 2000 and 2001, the other key elements of the formula have not been adjusted since 1991, which has reduced the number of people eligible for credits, the portion of people qualified for the maximum credit, and the effective value of the credits. Without any adjustment for inflation, DOR estimates that the credits would decline by \$8.9 million in 2007-09.

The Governor’s proposal to index the Homestead Credit formula does not undo past erosion of the program, but it is a very welcome development and is expected to result in a net increase in spending for the credits of \$3.1 million over the next two years.

Homestead Credit Formula Factors: 1985 and 2006

	2006 Parameters	1985 Parameters		1985-2006 change	
		In 1985 \$s	In 2006 \$s ¹	\$s	%
Maximum Credit	\$1,160	\$960	\$1,799	-\$639	-36%
Maximum Property Tax Subject to Credit	\$1,450	\$1,200	\$2,248	-\$798	-36%
Full Benefit Limit	\$8,000	\$7,400	\$13,865	-\$5,865	-42%
Maximum Income Eligible for Credit	\$24,500	\$16,500	\$30,914	-\$6,414	-21%

¹ The inflation adjustments are based on the Consumer Price Index – urban series (CPI-U).