

POLICY BRIEF

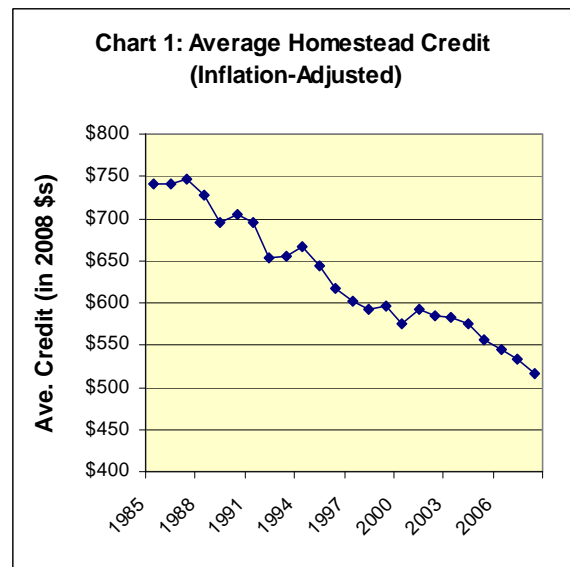
Ending the Erosion of the Homestead Tax Credit

Although the growth in property tax bills has been slower 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 it uses a formula that compares a household’s property taxes and income in order to deliver 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 \$763, or 40 percent, since 1985.
- The real value of the average credit has fallen by \$225, or 30 percent, since 1985 (see Chart 1).
- The number of households getting credits peaked in 1980 and has declined by 26 percent since then, even as the state population grew by more than 20 percent.
- Inflation-adjusted state spending for the program fell by almost 50 percent since its peak in 1980.

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

The 2007-09 budget bill

The Governor's 2007-09 budget bill would have indexed the credit for inflation, beginning with tax year 2007. It called for indexing all the formula factors. His recommendations were approved by the Joint Finance Committee and the Senate, but not by the Assembly.

The Assembly's version of the budget approved indexing the upper income ceiling, but not the rest of the formula. In addition, it would have cut more than \$106 million over two years by ending eligibility for unmarried people under age 65 with no dependents. The final budget bill ultimately approved by the Conference Committee maintained the prior law.

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, as the Governor proposed in his 2007-09 budget.

In light of the significant increases in property taxes since the whole formula was

changed in 1991, we would optimally like to see all of the formula factors adjusted back to their value at that time. However, in light of the state's extremely large budget deficit, recouping the value lost because of past inflation probably isn't a realistic option. Yet the credit could be indexed prospectively at little or no cost in the 2009-11 biennium.

At some future date when the state's finance's are in better shape, or if the state makes comprehensive tax reforms, the Homestead Credit should be increased to compensate for decades of erosion. For now, however, a minimum improvement would be to prevent future declines by indexing.

Conclusion

The Homestead Tax Credit provides much less property tax relief than it once did because it has been severely eroded by inflation. The upper income limit has not been increased since 2001, and the other key elements of the formula have not been adjusted since 1991. This 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.

By tax year 2010, if not sooner, all the credit formula factors should be indexed for inflation to prevent continued erosion of the Homestead Credit.

Homestead Credit Formula Factors: 1985 and 2008

	2008 Parameters	1985 Parameters		Change in value: 1985-2008	
		In 1985	In 2008 \$s	\$s	Percent
Maximum Credit	\$1,160	\$960	\$1,923	-\$763	-40%
Maximum Property Tax Subject to Credit	\$1,450	\$1,200	\$2,403	-\$953	-40%
Income Limit for Full Benefit	\$8,000	\$7,400	\$14,820	-\$6,820	-46%
Maximum Income Eligible for Credit	\$24,500	\$16,500	\$33,044	-\$8,544	-26%