Fiscal Note & Local Impact Statement

123 rd General Assembly of Ohio

BILL: **H.B. 390** DATE: **October 13, 1999**

STATUS: **As Introduced** SPONSOR: **Rep. Flannery**

LOCAL IMPACT STATEMENT REQUIRED: **No — No local cost**

CONTENTS: **Create the Homestead Tax Reduction Fund that increases the credit received by homestead exemption program recipients through the taxable value reductions when a state revenue surplus exists in any fiscal year.**

State Fiscal Highlights

- The bill would create a Homestead Tax Reduction Fund that would use unanticipated surplus revenues to increase taxable value levels in the homestead exemption program, up to 200 percent of original values. Any remaining revenues would then go into the Income Tax Reduction Fund for distribution back to income tax filers.
- If state surplus are equal to or less than the cost equivalent of increasing the homestead exemption program's taxable values by 200 percent, then all the surplus would go into the Homestead Tax Reduction Fund, leaving no money for the Income Tax Reduction Fund.
- For taxes paid in 1999 and filed in 2000, the Income Tax Reduction Fund is expected to refund $293.2 million with a 3.63 percent income tax rate cut. If this bill were enacted, $72 million would go to the Homestead Tax Reduction Fund for additional property tax relief to homestead recipients and $144.2 million would be refunded to income tax filers with a 1.10% income tax rate cut.
- It is possible that the increased benefit and resultant publicity might cause additional applications and cost to both the basic homestead program and this additional credit. There is some circumstantial evidence that at upper income levels of the program where current benefits are low, a significant percentage of potential eligibles do not apply. This might change somewhat if this proposal was enacted.
- At this point, it is not anticipated that any income tax rate reduction will occur for taxes paid in 2000 and filed in 2001. But, if expenses are less than appropriations or revenues are more than estimated, then a surplus could develop.

Local Fiscal Highlights

- No direct fiscal effect on political subdivisions.

Detailed Fiscal Analysis

The bill would create the Homestead Tax Reduction Fund, similar to the Income Tax Reduction Fund, that would provide additional property tax relief to homestead exemption program recipients when the state experiences a budget surplus. The Tax Commissioner is charged with increasing taxable value amounts used in determining homesteader's property tax credit in the same proportion, up to a maximum of 200 percent of original value (rounded to the nearest fifty dollar increment). This increase is not permanent and valid for just the year of the budget surplus. Any left over budget surplus revenue would then be put into the Income Tax Reduction Fund for income tax filer rebates.

Income Tax Reduction Fund

The income tax reduction fund (ITRF) was created to rebate unanticipated surpluses back to the taxpayer and has been reducing income tax rates since 1996. Once the year end fund balance is known, the Office of Budget and Management (OBM) compares the Total Fund Balance (General Revenue Fund balance + Rainy Day Fund balance) to the maximum year-end balance, with the difference (surplus revenue) becoming the basis for the tax cut.[1] Then, given the estimated number of filers for 1999, a tax rate cut is determined by the Tax Commissioner that would exhaust OBM's estimated surplus. Table 1 shows the surplus monies and resulting income tax rate cuts over the last four years.

Table 1
Fiscal History of the Income Tax Reduction Fund

	1996	1997	1998	1999
Surplus (in millions)	\$400.8	\$262.9	\$701.4	\$232.2
Tax Rate Reduction	6.61%	3.99%	9.34%	3.63%

Ohio's income tax collection is based on nine income levels, each with their own tax rate. The ITRF reduces each of these nine levels by the same percentage, before credits. Given different assumptions of filing status, dependents, exemptions, and credits, it is possible for a taxpayer to see a little more or a little less than the tax rate reductions in their actual taxes paid.

Homestead Tax Reduction Fund

The proposed Homestead Tax Reduction Fund (HTRF) works in an analogous way, but in the property tax credit arena. There is not literally a homestead property tax the fund reduces, but would increase the allowable credit disabled and senior citizens with incomes less than \$23,000 receive on their property tax bill under the Homestead Exemption Program.

The homestead exemption program allows senior citizens, disabled persons, and surviving spouses who own and occupy their principal residence and whose total income is less than \$23,000 to receive a reduction in taxable property value. The program cost is reimbursed by the state to local

[1] End of year balances corresponds to the fiscal year, July 1 – June 30. Therefore, the tax rate reduction seen on taxes paid in calendar year 1999 and filed in April, 2000 are based on the revenue surplus over the time period July 1, 1998 – June 30, 1999.

taxing districts. Recently enacted legislation (S.B. 6 of the 123rd G.A.) indexed qualifying income brackets to the GDP deflator beginning in tax year 1999 and indexed taxable value reduction beginning in tax year 2001. In 1998, the homestead exemption program had 242,525 participants at a cost of $66.8 million.

Under current law, the reduction in value is calculated based on the guidelines presented in Table 2.

Table 2: Current Law Homestead Qualifications and Reductions	
Total Income	**By the lesser of:**
Total Income ≤ $11,900	$5,000 or 75% of Total Income
$11,900 < Total Income ≤ $17,500	$3,000 or 65% of Total Income
$17,500 < Total Income ≤ $23,000	$1,000 or 25% of Total Income
Total Income ≥ $23,000	$0

Persons applying for the exemption calculate their total qualifying income based on the following formula:

Federal Adjusted Gross Income	
+	Nontaxable Social Security Retirement Benefits and Survivor Benefits
+	Nontaxable Retirement, Pension, and Annuity Benefits
+	Interest on Tax Exempt Government Obligations
-	Disability Payment paid by Veterans Administration or any branch of Armed Forces
-	All other Disability Benefits up to a maximum of $5,200
=	Total Income

The homestead applicant's credit is determined as follows:

(1) Calculate total income of the applicant.
(2) Given total income, the property tax payment reduction (homestead credit) is determined. For the majority of applicants, the lesser amount of the discrete dollar value reductions or the percentage of total income (see Table 2) is the discrete value reductions ($5,000, $3,000, or $1,000).
(3) The value reduction amounts are then multiplied by the tax district's *gross millage* rate. This product is the amount by which the homesteader's property tax bill is reduced, which the state reimburses local taxing districts. (See Appendix for detailed examples.)

The HTRF would increase, up to a maximum of 200 percent of value, the reduction amounts in Table 2 of $5,000, $3,000, and $1,000. Therefore, the maximum increase would result in reductions of $10,000, $6,000, and $2,000. The homesteader's benefit, and, therefore the cost of the program, lies in the taxable value reduction amounts. Any percentage increase in the taxable value reductions translates almost one-for-one into the same percentage increase in the program's cost, as well as the same percentage increase in the homestead recipient's credit. LBO has estimated that the homestead exemption program will cost approximately $72 million in 1999. The Tax Commissioner would therefore use $72 million of the estimated budget surplus of $293.2 million to double the taxable value reductions for a one-year increase in the homestead credit. For the individual homesteader, they would essentially see a doubling of their credit. The total homestead program cost would be $144 million ($72 million under current law and $72 million in additional credits). The increases and anticipated average credit are shown in Table 3.

Current Law		Homestead Reduction Fund		Additional Program
Taxable Value	Avg Credit*	Taxable Value**	Avg Credit*	Cost/HEX Savings
$5,000	$292	$10,000	$584	$292
$3,000	$188	$6,000	$376	$188
$1,000	$63	$2,000	$126	$63

* Average credit was calculated using 1996 homestead data, which is the most recent by bracket data.
** New taxable value reduction is 200 percent of current amount.
Note: The program cost of the homestead exemption program is expected to increase 15%-20% over time due to recent enactment of S.B. 6

Using the maximum increase in taxable value reduction, the fiscal effect on the ITRF would be that $144.2 million (of the currently allotted $293.2 million) is refunded to tax payers, with a decrease in the tax rate cut to 1.10% (current rate is 3.63%).

Distribution Effect

Currently, the ITRF uses the unanticipated budget surplus to reduce tax rates for each person filing a tax return for tax year 1999. The surplus "pot" is spread thinly over a large number of taxpayers. Implementation of the HTRF would spread a thinner layer of rebates over all income tax filers, while at the same time providing a larger tax credit to a smaller group of property tax filers (estimated to be approximately 280,000 in 1999).

It is possible that the increased benefit and resultant publicity might cause additional applications and cost to both the basic homestead program and this additional credit. There is some circumstantial evidence that at upper income levels of the program where current benefits are low, a significant percentage of potential eligibles do not apply. This might change somewhat if this proposal was enacted.

At this point, it is not anticipated that any income tax rate reduction will occur for taxes paid in 2000 and filed in 2001. But, if expenses are less than appropriations or revenues are more than estimated, then a surplus could develop.

❑ *LBO staff: Jeff Petry, Economist*

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Appendix – How the Homestead Reduction is Calculated

1. Assume a home's appraised value is $100,000.
2. Determine the assessed value by multiplying the appraised value by 35%. Here, the assessed value would be $35,000.

3. Assume the homesteader's income falls in the "less than $10,800" income bracket with $10,799 in total income. The reduction is the lesser of 75% of taxable value or $5,000.
   - 75% × $35,000 = $26,250
   - $5,000 is less than 75% of assessed value

To determine the taxable value reduction in the tax bill, $5,000 is multiplied times the tax rate where the property is located. Assume we take Hamilton City's gross tax rate of 56.40 mills (1996) times the taxable value reduction.

- $5,000 × 0.05640 = $282.00

4. **Therefore, the tax bill reduction for a person with a total income of $10,799 and a gross millage rate of 56.40 mills is $282.00. (Using Effective mills, 38.83, the tax bill reduction would be $194.15, a subsidy of $87.85)**

5. Assume the homesteader's income falls in the "$10,800 to $15,800" income bracket with $15,799 in total income. The reduction is the lesser of 60% of taxable value or $3,000.
   - 60% × $35,000 = $21,000
   - $3,000 is less than 60% of assessed value

To determine the taxable value reduction in the tax bill, $3,000 is multiplied times the tax rate where the property is located. Assume we take Hamilton City's gross tax rate of 56.40 mills (1996) times the taxable value reduction.

- $3,000 × 0.05640 = $169.20

6. **Therefore, the tax bill reduction for a person with a total income of $10,799 and a gross millage rate of 56.40 mills is $169.20. (Using Effective mills, 38.83, the tax bill reduction would be $116.49, a subsidy of $52.71)**

7. Assume the homesteader's income falls in the "$10,800 to $15,800" income bracket with $20,799 in total income. The reduction is the lesser of 25% of taxable value or $1,000.
   - 25% × $35,000 = $8,750
   - $1,000 is less than 25% of assessed value

To determine the taxable value reduction in the tax bill, $1,000 is multiplied times the tax rate where the property is located. Assume we take Hamilton City's gross tax rate of 56.40 mills (1996) times the taxable value reduction.

- $1,000 × 0.05640 = $56.40

8. **Therefore, the tax bill reduction for a person with a total income of $20,799 and a gross millage rate of 56.40 mills is $56.40. (Using Effective mills, 38.83, the tax bill reduction would be $38.83, a subsidy of $17.57)**