Fiscal Note & Local Impact Statement

123 rd General Assembly of Ohio

BILL:	**Sub. S.B. 6**	DATE:	**April 21, 1999**
STATUS:	**In House Ways and Means**	SPONSOR:	**Sen. Armbruster**

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

CONTENTS: **Increase qualifying income limits for the homestead exemption and indexes all qualifying income brackets and taxable value reductions to inflation using the GDP deflator. Maintain disability benefit deduction for homestead recipients at age 65.**

State Fiscal Highlights

STATE FUND	FY 2000	FY 2001	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	$3.0 million to $5.5 million increase	$7.4 million to $12.4 million increase	Annual cost increasing to $20 million by FY 2004

Note: The state fiscal year is July 1 through June 30. For example, FY 2000 is July 1, 1999 – June 30, 2000.

- The cost of future years will grow by approximately $2 million to $3 million each year, on top of the $6 million - $11 million initial increase in tax year 1999. Therefore, tax year 2000 will cost $8.7 million to $13.7 million, tax year 2001 will cost $11.4 million to $16.4 million, tax year 2002 will cost $14.2 million to $19.2 million, and so forth.
- By allowing disabled homestead recipients to maintain disability deductions from qualifying income after turning age 65, the number of individuals qualifying for the homestead exemption will increase slightly and some disabled individuals in the program will qualify for greater tax relief.
- By allowing current homestead recipients to recalculate income by maintaining disability deductions, the former disability recipients that turned 65 over the last 10 years or more are potentially eligible to have their homestead eligibility recalculated.

Local Fiscal Highlights

- No direct fiscal effect on political subdivisions.

Detailed Fiscal Analysis

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 $20,800 to receive a reduction in taxable property value. The program cost is reimbursed by the state to local taxing districts. Sub. S.B. 6 would allow disabled persons to continue deducting disability benefits from total income, increase and index to inflation all three qualifying income brackets, and index to inflation taxable value reductions. To determine state cost of the bill, six components must be estimated: (1) The number of disabled persons who were completely removed from the homestead program when they turned 65; (2) The number of disabled persons who lost a portion of their homestead exemption when they turned 65; (3) Disabled persons who fell into categories (1) or (2) in the past and may now claim a larger homestead exemption; (4) Tax Year 1999 increase in new homestead participants from increasing the qualifying income brackets; (5) Number of new homestead participants and participants shifting brackets in future years from income brackets being indexed for inflation; and (6) Additional cost due to indexing taxable value reduction brackets to inflation.

Maintaining Disability Deduction at Age 65

Persons applying for the homestead exemption program 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

When a disabled person turns 65, disability benefits from the Social Security Administration are reclassified as retirement benefits. With no change in total income, a disabled person may lose all or a portion of their homestead exemption due solely to reclassification.

To estimate the impact of allowing disabled persons to continue deducting disability benefits from total income, LBO obtained data from all 88 counties regarding disabled persons who lost their entire exemption due entirely to turning 65 in tax year 1997. This information is not readily available from the county auditors, but eighteen counties (representing 26 percent of all homesteaders) were able to provide the exact number of persons who lost the entire exemption due solely to reclassification. Fourteen of the eighteen counties reported zero or one persons losing their entire exemption and the other four counties reported 2, 4, 6, and 13 persons losing their entire exemption. Two of the eighteen counties (Cuyahoga and Ashtabula) supplied detailed information of persons who lost all or a portion of their exemption. The remainder of the counties (70) provided estimates of the number of persons losing their entire homestead exemption in tax year 1997.

Cuyahoga County has the largest number of qualifying homeowners, with 39,304 (15.5 percent) of the 249,798 exemptions granted in tax year 1996. They reported zero persons losing the entire exemption and 105 persons losing a portion of their exemption. The average credit loss was $71.66 per person, with a total county credit loss of $7,524.30.

Ashtabula County is the twentieth largest homestead county with 3,098 exemptions granted in tax year 1996. They reported one person losing the entire exemption and eight persons losing a portion of their exemption. The average credit loss was $229.46 per person, with total county credit loss of $2,065.13.

Given the wide disparity in the impacted number of individuals, LBO estimated the additional cost based on the exact measure provided by eighteen counties and the estimates of counties (52) projecting losses within the reasonable bounds of the actual data values.[1] For persons who lost their entire exemption and for persons who still qualify for the exemption but received a smaller amount, the estimated state cost increase will be approximately $200,000 per tax year for disabled persons turning 65 in that year.

However, persons who currently qualify for the program based on age and had received a disability exemption before age 65 are also eligible for a recalculation of homestead benefits, potentially increasing their exemption amount. It is difficult to estimate how many persons are eligible for recalculation of their exemption, but the first years of the program will have a higher cost increase as a result. After the first few years, cost increases will taper off as the number of new eligibles and the number leaving the program reach a balance point. LBO estimates the first year of the program will see an additional cost increase between $500,000 to $1,000,000. Subsequent years would see additional cost increase, as more recipients become eligible for the program. While $200,000 in new recipients would be eligible for the program each year, other recipients would drop off the rolls due to changed circumstances. Total annual costs of maintaining the disability deduction will be in the $1 million to $2 million range after half a dozen years and remain approximately constant at that point.

Discrete Increase in Maximum Qualifying Income Bracket

By using 1996 data (most recent data available) on the number of homestead applicants by current income brackets, LBO estimated the additional cost from a discrete increase in the qualifying income brackets.[2] Table 1 shows the current income brackets, Sub. S.B. 6 income brackets, and the estimated cost of Sub. S.B. 6 by bracket. Since exact data is not available on individual homesteader's income, observations from the 1995 total income bracket change were used to determine the movement of homesteaders in Sub. S.B. 6 brackets.

[1] Estimated data ranged from zero to 550 person losing their entire exemption. Using exact data and discussions with auditors, a reasonable bound was made at 25 persons. Fifty-two of the seventy counties reported 25 persons or less losing their entire homestead exemption. Estimates were made for the remaining 18 counties.

[2] Department of Taxation data set.

Table 1: Per Income Bracket Cost Increase of Sub. S.B. 6		
Current Brackets	**Sub SB 6 of 123rd G.A.**	**Estimated Cost Increase**
T.I. ≤ $10,800	T.I. ≤ $11,900	$3 million to $5 million
$10,800 < T.I. ≤ $15,800	$11,900 < T.I. ≤ $17,500	$1 million to $3 million
$15,800 < T.I. ≤ $20,800	$17,500 < T.I. ≤ $23,000	$1 million
T.I. > $20,800	T.I. > $23,000	$0

Inflationary Indexing of Qualifying Income Brackets

The qualifying income brackets proposed by Sub. S.B. 6 are effective in tax year 1999, which will become the base year in which the gross domestic price (GDP) deflator is applied.[3] LBO subscribes to two forecasting firms and data was used from one of these firms, WEFA, to index Sub. S.B. 6 qualifying income brackets to inflation through 2004. This is presented in Table 2.

Table 2: Inflationary Adjustment of Qualifying Income Brackets through 2004					
$11,900 HEX Bracket		**$17,500 HEX Bracket**		**$23,000 HEX Bracket**	
Year	**Indexed Bracket**	**Year**	**Indexed Bracket**	**Year**	**Indexed Bracket**
1999	$11,900	1999	$17,500	1999	$23,000
2000	$12,200	2000	$17,900	2000	$23,500
2001	$12,500	2001	$18,300	2001	$24,000
2002	$12,700	2002	$18,700	2002	$24,500
2003	$13,000	2003	$19,100	2003	$25,100
2004	$13,300	2004	$19,500	2004	$25,600

Table 3 uses the same methodology as above to determine the inflationary increase in taxable value reductions.

Table 3: Inflationary Adjustment of Taxable Value Reductions through 2004					
$5,000 Taxable Value Reduction		**$3,000 Taxable Value Reduction**		**$1,000 Taxable Value Reduction**	
Year	**Indexed Bracket**	**Year**	**Indexed Bracket**	**Year**	**Indexed Bracket**
2000	$5,000	2000	$3,000	2000	$1,000
2001	$5,110	2001	$3,070	2001	$1,030
2002	$5,220	2002	$3,130	2002	$1,050
2003	$5,330	2003	$3,200	2003	$1,070
2004	$5,440	2004	$3,270	2004	$1,090

Inflationary Indexing of Total Program Cost

[3] The GDP deflator, as a measure of the overall price change in domestic goods, encompasses a broader range of domestic products than the consumer price index. It also allows for comprehensive substitution among goods and services.

Using the WEFA forecast of GDP deflator and assuming an increased cost of $7.5 million in the year 1999, it is possible to project future years' cost of the homestead exemption program. This is graphically done in Figure 1. First, data from 1985 through 1997 is adjusted for inflation, using the GDP deflator measure, to Tax Year 1997 (most recent data). A vertical line is drawn at tax year 1997 to separate the actual (adjusted) data from projected data. Second, the income bracket increases of 1988 and 1995 are indicated with a vertical line, along with the Sub. S.B. 6 tax year 1999 bracket increase.

Figure 1 data between 1997 and 1999 represent the projected trend under current law. From the base year of 1999, four projections are presented in Figure 1. The lowest line represents no change to the homestead exemption program. Based on historical data, the state cost decreases by about one-percent each year as homesteaders' come in and out of the program due to changes in their total income. LBO projects that the homestead program will cost $63.1 million in the year 1999 under current law, *ceteris paribus*.

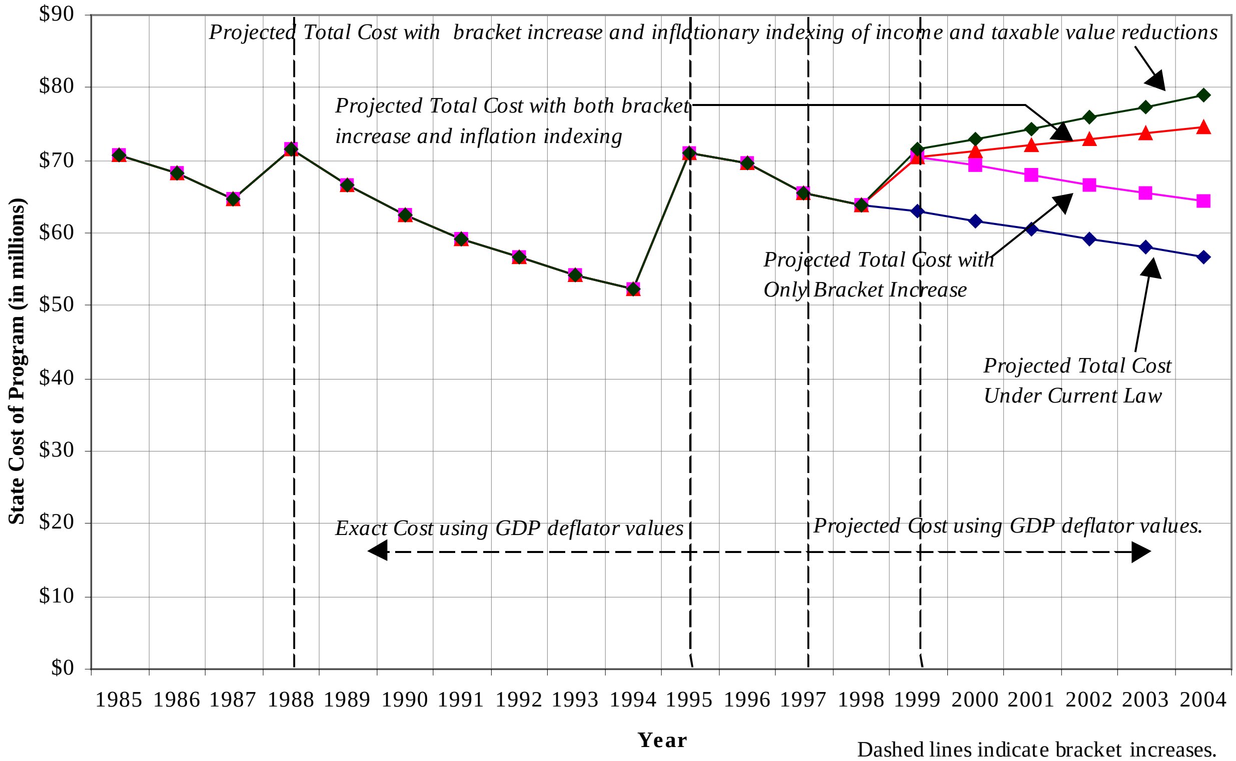
The second from bottom, downward sloping projection line represents a $7.5 million increase in the homestead program due to raising the qualifying income brackets and not adjusting the brackets for inflation. In tax year 1999, the homestead program would cost $70.6 million from just increasing the brackets.

The second from top, upward sloping projection line represents an initial $7.5 million increase in the homestead program due to raising and indexing the qualifying income brackets. There will be a net cost increase of approximately 1.1 percent annually or $800,000 in the first year solely from indexing.

The top projection represents an initial $7.5 million increase in the homestead exemption program due to raising and indexing the qualifying income brackets and indexing taxable value reductions to the GDP deflator. With expected inflation to be approximately 2.1 percent annually, inflation will add an additional $1.5 million to the homestead program. The difference between the top projection and the bottom project (current law) is the difference in annual cost, which grows by an additional $2 million each year.

Allowing disability benefits to be deducted from qualifying income will increase program costs by $1 million to $2 million annually. Additional annual cost from indexing the program from disability benefits is approximately $50,000.

Figure 1: Projected Program Cost With and Without Brackets and/or Indexing



Dashed lines indicate bracket increases.

Conclusion

The total effect of maintaining disability benefits deduction, indexing the homestead program to inflation, and increasing the qualifying income brackets is to increase the program cost by $6 million to $11 million in the first year (1999) and $2,800,000 each successive year thereafter, which, in total, is a $8.7 million to $13.7 million increase for the second year with further increases each successive year.

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