Follow-Up Questions on Local Government
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These are the questions submitted during the IP video presentation on February 1, 2008. Some of the questions have been edited for clarity. Questions have been grouped by category. There were a couple of questions that I'm afraid I didn't understand, and those have been left off the list.

For reference, the categories are:

<u>Questions about the circuit breakers</u>

What does the term "original" mean in "original market value" when assessing and applying the 1% circuit breaker for homeowners? If the assessment value of a home increases annually, the 1% cap or circuit breaker would continue to rise, correct?

I used the word "original" to mean the market value assessment, before deductions are subtracted. That's sometimes called the "gross assessed value."

Yes, the 1% cap in HB1001 as proposed and passed applies to the gross assessed value of the home, so if the AV increases, so will the cap.

Have you estimated impact of circuit breaker tax credits on any counties other than the eleven most affected?

I haven't, but the Legislative Services Agency has estimated the impact for every unit of government in the state. I've got their latest memo on my website, under "Hot Topics," at www.agecon.purdue.edu/crd/Localgov .

Can you explain the circuit breaker concept in simple terms, using real numbers, and the distinction between circuit breakers based on assessed value vs. based on personal income?

Is it likely or possible that the definition of circuit breaker will be based on income as opposed to property? Older/fixed income would not be impacted.

Suppose a homeowner has a house with a gross assessed value of $100,000. That's the market value before deductions are subtracted. The 1% circuit breaker cap means that the homeowner would not have to pay more than $1,000 in property taxes in any year.

The net taxable assessed value for this homeowner would be about $32,750. That's the market value assessment of $100,000, less the $45,000 homestead deduction, less the additional 35% homestead deduction (35% of the remaining $55,000), less the mortgage deduction of $3,000. If the tax rate in the homeowner's taxing district is $2.50 per $100 assessed value, the homeowner pays $819 (2.5% of $32,750). The homeowner does not qualify for the 1% circuit breaker. If the tax rate is $3.50, though, the tax bill would be $1,146, and the homeowner would get a $146 circuit breaker credit. The local taxing units would lose this $146, based on their shares in the total tax rate.

A tax bill of $1,000 still might be pretty stiff for a low income homeowner. Most states that use circuit breakers base them on shares of income. A circuit breaker might limit property tax payments to (say) 4% of taxable income. If the homeowner had a taxable income of $20,000, property taxes would be capped at $800, and the homeowner would receive a refund for $19.

A circuit breaker based on income can target tax relief to those with higher valued property but lower incomes. Retired homeowners are sometimes in this category. However, it would require establishing some link between taxable income and taxable property, something that our tax system does not do at present.

There's been a move for an income-based circuit breaker in the House of Representatives. The issue may have to be addressed in conference committee.

Will the courts find HB 1001 "Fair"?
The question refers to the differences between the circuit breaker limits on residential property (1% of gross assessed value), rental housing and agricultural property (2%) and business property (3%). The Constitution says "the General Assembly shall provide, by law, for a uniform and equal rate of property assessment and taxation. . . ." (Article 10, Section 1. See it at www.in.gov/legislative/ic/code/const). Different circuit breaker limits don't sound "uniform and equal", so perhaps they will be open to challenge. That may be one reason why there's an effort to amend the different limits into the Constitution.

On the other hand, the Constitution also says that the General Assembly can exempt real property "used as a principal place of residence." This was added by referendum in 2004, to authorize the big homestead deduction enacted during the 2002 session. Maybe a judge will regard the differential limits as a partial exemption of residential property. That would still leave the 2% limit for rental housing and agriculture in question, though.

Will the courts find HB1001 fair? No one knows. The lawyers I know say "you never know what a judge will do."

Will the circuit breaker for businesses come in to play?
Yes, for some businesses in some counties. Legislative Services estimated the circuit breaker savings by property type, and found that $157 million of the $636 million in

circuit breaker credits estimated for 2010 came from "other real property" and "personal property." These are business property categories.

This happens even though the circuit breaker limit is 3% of gross assessed value for business property. Businesses have not received many property tax breaks in the past (compared to the deductions and credits offered to homeowners). That means they pay a higher share of assessed value in property taxes, so some are eligible for even a high circuit breaker cap.

I've put LSA's analysis on my website. See "bill as passed" under "Hot Topics," at http://www.agecon.purdue.edu/crd/Localgov .

Questions about other provisions in HB1001

How are they going to justify the cap on age 65+ homeowners. Their taxes went up last year.

This refers to Section 287 of HB1001 as it passed the house. Homeowners over age 65 can apply to defer their property taxes until they no longer live in the house. They can defer taxes on any amount greater than 125% of their assessed value in 2003, or their assessed value in 2004, whichever is less. So, if their taxes went up last year because their home assessments increased, they can defer taxes on that amount, and any increases all the way back to 2004. The taxes are just deferred—eventually they must be paid, by the new owners or the heirs.

If the governor plans to borrow $800M from state surpluses this year, where will the money come from after the first year?

Legislative Service's fiscal note on HB1001 as passed provides information on the balance between new revenues and new expenditures. (Note that this is the governor's plan as amended by the House.) Go to www.in.gov/apps/lsa/session/billwatch/billinfo and type "1001" in the "Go To Bill:" box.

In fiscal 2008 (through the end of June, 2008) sales taxes are expected to bring in $152 million, and an added homestead credit to cost $350 million. The $198 million difference will have to come from balances. In fiscal 2009, added revenues are $870 million, mostly from the sales tax, and added spending is $893, mostly for the property tax levy takeovers. That's a $23 million deficit. In fiscal 2010, added revenues are $938 million, added spending is $1,151 million, a $213 million deficit. In the three years revenues fall short by about $434 million.

The state's balances at the end of fiscal 2007 were $1,286, just about 10% of the budget. That's really not enough to absorb $434 million, so revenues will have to be found, or spending scaled back.

Questions about Indiana property taxes as they currently exist

An unfair question! If LaPorte County was in the 13 – 23% tax increase category and the legislature changed by 12%, who isn't doing their job?

This refers to the map of county average homestead tax increases in 2007, provided by the Department of Local Government Finance, at www.in.gov/dlgf/local/homestead-increase.html . LaPorte's average homestead owners saw a tax bill increase of between 13 and 23%.

You'll see on the map that there was a large variation in homestead tax increases among the counties, all the way from tax increases of 42% to tax cuts of 3%. This does not necessarily mean that someone wasn't doing his or her job. Variations could be caused by differences in the composition of the tax base (were there lots of inventories to exempt?), differences in levy growth (were there new school buildings or jails?), or differences in the appreciation of property (have prices increased a lot since 1999?). But it could also reflect underassessment of residential property during the last reassessment in 2002, or under-trending of business property last year. The DLGF cited several counties for failing to adequately assess business property. In that sense, I guess, someone didn't do their job.

On the slide with the school debt…Does that top bar include pension bond debt –which schools are required to pay, but are tax neutral?

This refers to the graph on page 13 of the handout. The "school debt service" bar does include both construction debt and pension bond debt. However, if pension debt is removed, construction debt still increases an average of 8.3% per year, still the fastest growing part of the levy by a couple of percentage points.

Why would farm land without a house have a homestead credit on the bill? [We have one here.]

I can't think of a reason, other than it's a mistake. You might want to check with your county auditor (or, if that's your tax bill, maybe not!).

How much did the elimination of the Inventory tax have on the present property tax situation?

Statewide, the elimination of inventory taxes in the remaining 51 counties (those that didn't take the option of eliminating early) added about 4% to the increase in homeowner taxes in 2007.

Going back a bit, in 2002-2003, after market value reassessment but before many counties had exempted inventories, owners of inventories paid $369 million in property taxes, about 7% of the total. Roughly, then, the elimination of inventories has increased property taxes for other property owners by about 7%.

Questions about property assessment

What affect could trending have on this entire property tax conundrum with impending recession?

If trending goes down – how does this impact revenue?
Trending should increase assessments when property values are rising, and decrease them when property values are falling. This happens with a lag—2008 tax payments are based on assessments trended to 2006 property values.

If a recession reduces property values, assessments should fall, after a couple of years. This wouldn't do much to local revenues if the tax rate were allowed to rise to offset lower assessments. But if lots of local taxpayers are at their circuit breaker limits, a fall in assessed value will reduce the taxes they pay, no matter what happens to the rate. That would reduce local revenues. Trending plus the circuit breaker could make the property tax more vulnerable to recession.

How is the farm land base rate established?
It's calculated using a capitalization formula. A measure of net income per acre is divided by an interest rate. Net income is based on land rents, commodity prices and yields, and on costs. The formula uses a 6-year rolling average to smooth out fluctuations. Lately, in the calculations net income has been rising and the interest rate has been falling, so the base rate has been increasing.

I did a column on this topic in January. You can find it at www.agriculture.purdue.edu/agcomm/newscolumns/CCarchives.htm .

Why did we not wait to do trending until after the next reassessment?
First, because the Supreme Court in 1998 required that assessments be based on "objective measures of property wealth." If we wait about a decade between reassessments, we'd be hard put to say we were meeting that requirement.

Second, if we waited, the tax shifts in the next reassessment would have been even larger than what we experienced with trending last year. Trending created tax shifts partly because six years of property appreciation were incorporated into assessments all at once. If we had waited until the next reassessment, for taxes in 2012, it would have been nine or ten or eleven years of appreciation. As it is, if we do trending right from now on, we won't have any more big tax shifts like we've always had during reassessments, because the big tax shift will have been spread out over the years between reassessments.

From an administrative point of view, though, it might have been easier and maybe cheaper to wait.

Questions about local option income taxes

Is there such a thing as a Public Safety Tax in the new proposal?
No, not in HB1001 as it passed the House. This was one of three new income taxes provided by the 2007 General Assembly, and the only one that allowed local governments to raise additional revenue for services, rather than use the revenue for property tax cuts. The three income taxes are combined into one in HB1001, but all of the revenue must be used for property tax relief or to replace revenue lost to the circuit breaker limits.

What is the distribution formula for LOIT? How do cities get some of the money? Is it strictly per capita?
Actually, very little of it is per capita. Mostly the local income tax revenue is distributed based on shares in the total county tax levy. The city share of the total levy equals its share of local income tax revenue. I've got a page on the local income taxes on my website, at
www.agecon.purdue.edu/crd/Localgov/Topics/Essays/Income_Tax_Local.htm .

Questions about school corporation issues
What are the policy implications of state school funding, taking this out of local hands/control?

Property tax reform aside, do we need to move control of school general funds to the state? Indiana is rural and urban/industrial and agricultural. Why make a 'one-size fits all' central control?

We do not understand about the school corporation tax works, but could there be a "per student cost" that each county would equally pay vs a "poorer county seems to pay more than a richer county" pays now?
There are many implications of a state takeover of school general fund spending, including some that we haven't thought of yet, no doubt. Here are three:

- Sales and income taxes are less stable than property taxes. If the general fund if fully funded by the state out of its budget, will school spending be more difficult to maintain in recessions? We may find out sooner than later!
- The existing state aid formula partially equalizes general fund spending, by providing more aid to less wealthy corporations, and less aid to more wealthy corporations. If the state pays the whole general fund, what will be the justification for the remaining differences, especially to wealthy corporations that spend more? Will these corporations have to cut their spending? Will their spending growth be limited until lower spending corporations catch up? Will the problem be ignored until the court case is filed?
- It's been suggested that the state will need to negotiate a statewide teacher contract. If so, will there be variations in wages and benefits by (say) cost of living across the state, which is a rural/urban difference? Will negotiations about working conditions be included? Does that mean we'll need a statewide policy on

(say) school schedules? Will the public accept having teachers be the highest paid professionals in some lower income rural counties, and the lowest paid professionals in some higher income suburban counties?

It seems to me suburban areas will have similar tax effects as rural areas—a low number of business and industrial properties. How will this affect towns and cities and their related units?
This issue came up in a discussion about places that might have more or less success in passing construction bond referenda. Past research has identified the "tax price" as one factor that matters. That's the added taxes that the bond issue will cost the typical voter. The higher the tax price, the less likely voters will approve.

Tax prices will be highest where assessed value per capita or per pupil is lowest. Debt service costs must be spread over less assessed value, so tax rates are higher for each taxpayer. Places with lots of commercial, industrial and utility property have lots of assessed value. Their debt service tax rates are likely to be lower, so they may have an easier time passing bond referenda. Rural places with only houses and farm land have less assessed value, so they may have a harder time passing referenda. Many suburban places would also be like rural places. If all the community has are mid-valued houses, assessed value per person is likely to be low.

Big discussions here (Hendricks County) about ending construction control at the school level, and the fact that it will negatively impact local contractors, plumbers, etc. These projects create economic development by bringing construction jobs as well as the staffing jobs. The feeling here is that no one is talking about this side of the equation and they would like to hear Larry discuss this point.
Government spending can have an impact on local economies. If the referendum requirement reduces the amount of construction activity, it makes sense that there would be fewer construction jobs.

However, local governments must balance their budgets, so less debt service means local taxpayers keep more of their income. When they spend this income it stimulates local economies, creating jobs in retail and other industries.

Where they spend this income is a question. If the construction companies are local, but the malls where people shop are in another county, it could be a net loss for a local economy. If the construction companies are from out of the county, but the malls are local, it could be a net gain.

There could be some "supply side" effects as well. If school facilities cannot be expanded or repaired, and education suffers, firms might look elsewhere for quality workers. But lower taxes on business property tend to encourage firm location and investment.

Questions about government reorganization

Statewide, we've been told, only 2% of the budget goes to township government. How much do Township governments really affect the economy and the tax rate?
Eliminating township assessors, or all of township government, can't have much effect on taxes. Townships collect between 2% and 3% of the tax levy statewide, and if their functions are taken over by counties, presumably county taxes will have to rise.

I think the move to eliminate townships has more to do with the quality of services. Research indicates that full time assessors with modern tools achieve more accurate assessing results. Township-trustee assessors are usually part-time. It also may be that township boundaries may not be the most efficient to use for fire departments.

Is it true that elected township assessors with 15,000 parcels or more will be retained? What will happen in a township that is experiencing growth of 235 parcels per year? What happens when they reach the 15,000 mark?
These limits are in Senate Bill 16. The bill says that a new township assessor's office can be established, and a township assessor elected, when the number of parcels grows to 15,000. You can see the bill at www.in.gov/apps/lsa/session/billwatch/billinfo . Type "16" into the "Go To Bill:" box.

Would it make more sense to make a minimum amount of assessed value and or minimum number of parcels?
It might, if it's more costly or difficult to assess higher valued properties. For run-of-the-mill houses, it's probably the quantity of parcels that matters for the difficulty of the assessor's job. More expensive, unique houses, and non-residential business property might be more difficult to assess, though, and then assessed value might be the better measure.

Research by Sjoquist and Walker (*National Tax Journal*, 1999) on economies of scale in property assessment found that measuring the volume of assessment work using parcels or using value gave similar results.

What happens to township fire departments if township trustees and boards are eliminated? This will most likely effect at least 80% of the fire dept in Indiana.
Senate Bill 309 and House Bill 1201 abolish most township governments, and transfer their functions to the counties. The county establishes some firefighting funds to pay for fire departments. Both bills died in committee.

The Kernan-Shepard Commission recommended abolishing townships, and assigning township duties to counties or cities. You can see their recommendations at http://indianalocalgovreform.iu.edu/ .

Statistics nationwide indicate the consolidation of public safety agencies results in longer response times in emergencies, thereby greatly effecting property loss outcomes and injury outcomes. Are the legislators considering this impact?
It's too early to tell, I think. Other than assessment reform, the Kernan-Shepard Commission recommendations aren't getting much play this session. Property tax reform has filled the agenda. If the recommendations are going to be considered seriously, it will probably happen in the long session next year.

Will Larry discuss/review the legislative change and the role of County Council?

What is the latest on the capitol project review board, current legislation vs. proposed?
HB1001 as passed in the House transferred the duties of the county board of tax and capital projects review to the county council. The councils would be responsible for reviewing and approving (or not) the eligible capital projects of the school corporations, cities and towns, library districts and other units within the county. These county capital projects boards haven't started operation yet—they're on the books and will start operating in 2009.

The Kernan-Shepard commission report had a similar idea, recommending that school bond issues be reviewed by the county council or city council where it had the most assessed value. The idea was to use existing government bodies for the review process, rather than invent another layer of government.

<u>General questions about taxation and economics</u>

Why do they feel that landlords will lower rents? I have not heard of one RV company that lowered the price of their units when the inventory tax was removed.

This question refers to the contention of most economists that changes in property taxes, *in either direction*, will eventually, partially be reflected in rents paid by tenants. If the circuit breaker rate limits reduce taxes on landlords, as they are expected to do, some of those tax cuts will go to lower rents.

Prices and rents are a matter of demand and supply, so here's what has to happen for rents to fall. Lower property taxes make owning rental housing more profitable. So landlords build more apartments and convert more owner-occupied structures to rentals. To fill these new units with tenants, they must reduce the rents, or at least increase them more slowly than they would have. So, if lower property taxes lead to a rental building boom, tenants will see lower rents. It takes time and it's not dollar for dollar. Research by economists Carroll and Yinger (*National Tax Journal*, 1994) looked at property taxes and rents in Boston, and found that each one dollar reduction in property taxes reduced rents by 15 cents.

So why didn't the inventory tax elimination cause the RV manufacturer to cut its prices? Perhaps the tax cut didn't increase the profitability of RV's enough to cause the company to expand production. With no increase in supply, there would be no drop in price. And, likewise, if the rental housing tax cut doesn't encourage new construction, rents won't drop either.

Who is paying attention to the impacts on rural counties, as opposed to others?
Mainly, of course, the elected House and Senate members from rural counties are responsible for promoting the interests of their constituents. Interest groups such as the Farm Bureau also keep track of the impacts of new proposals on rural areas.

So, if all this "muddy taxation" makes for an Indiana system which is flawed, what state does it right? Where is the best model that allows for a balance of services and taxes?

Are there core principles we can apply to "property tax relief" that will affect the Common Good?!?
I really don't think there is a "best" model, because every state's tax base, service preferences and history are different. There are some criteria that tax systems ought to meet. Taxes should be adequate to pay for services, stable in recession and inflation, transparent to taxpayers, easy to administer, should inhibit economic development as little as possible, and should be fair by some criteria accepted by the public.

Some of these criteria involve tradeoffs. Some think a fair tax is based on ability to pay, for example, which would imply that wealthy people pay more. But if a state charges wealthy people more, it may inhibit economic development, because these are the people who own businesses and make investment and location decisions. Do the state's people value fairness over development, or the other way around? There's no one answer for that, so there's no one answer for the best tax system.
I've got an essay on tax criteria on my website, at
www.agecon.purdue.edu/crd/Localgov/essays/goodtax.htm .

What impact or enhancement have casino revenues or tobacco revenues had on the tax equation?
The Indiana general fund received $617 million from riverboat taxes in fiscal 2007, and $368 million from tobacco taxes. Added casino revenues are coming from the two new "racinos", the racetracks that will install slot machines. They will pay a total of $500 million up-front for the licenses to install these machines, and in 2007 the General Assembly allocated all of this revenue to homeowner property tax relief in 2007 and 2008. The additional $80 to $90 million a year expected in tax revenue from these racinos is part of the revenue mix in HB1001.

Tobacco taxes haven't played much role in the property tax debate. Revenue from the recent increase in the cigarette tax is going to the new health insurance program for low-income people, and so won't be available for tax reform.

What effect does increase in sales tax have on the overall economy especially a recession?

Sales taxes tend to rise more slowly in recession (they usually don't fall, because inflation increases prices). Property taxes are largely immune to recession, because any decline in assessed value can be offset with tax rate increases. That means reducing property taxes and raising sales taxes makes Indiana's overall state and local revenue system more vulnerable to recession.

The property tax relief from the sales tax goes mainly to homeowners. Lower property taxes on homeowners could encourage more home construction and home ownership. Higher sales taxes on consumers discourage purchases of taxable goods, and may encourage some cross-border buying. Business-to-business sales are taxed too, so this is a kind of tax increase for businesses. Overall, it's hard to say how these tax changes balance out. Bohannon and Hicks did a series of studies of the economic impacts of various tax plans, at www.bsu.edu/cob/article/0,,56233--,00.html .

Please address taxing services.
Indiana doesn't tax many services with its sales tax, just utilities and some property rentals (not rentals of housing). Extending the sales tax to services could raise a lot more revenue from a given tax rate, or raise the same revenue we get now with a lower tax rate. Economists often recommend extending the sales tax to services, because taxing goods alone distorts the decisions consumers make about their purchases. Why favor services over goods?

However, there are (as always) some caveats. The potential revenues are greatly reduced if medical services are exempted from a sales tax on services. Revenues are reduced more if business-to-business sales are exempt. Using a model of sales taxes on services that I helped develop, taxing all services including medical, and exempting no business-to-business sales, just about doubles sales tax revenue. We could raise the same revenue we raise now with a 3% sales tax rate. Exempting medical reduces this increase from 100% to 75%, and exempting business to business sales reduces the increase to about 20%. With full exemptions, the tax on services might raise as little as a billion extra dollars.