



Revenue and Transportation Interim Committee

61st Montana Legislature

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April 19, 2010

TO: Revenue and Transportation Committee

FROM: Jeff Martin, Legislative Research Analyst

SUBJECT: Property Tax Circuit Breaker Options

House Bill No. 658 (Chapter 483, Laws of 2009) requested the Revenue and Transportation Interim Committee to review methods of providing assistance to property taxpayers, including circuit breaker programs and assistance to low-income, veteran, and elderly property owners and whether the assistance should be accomplished through income tax or property taxation means.

The purpose of this memorandum is to summarize some of the information the Committee has considered so far and to list several options for providing property tax assistance that the Committee may want to pursue.

BACKGROUND

At the December 3, 2009, meeting of the Revenue and Transportation Interim Committee, staff presented a background report on property tax circuit breakers. The more common types of property tax circuit breakers include a threshold circuit breaker and a sliding scale circuit breaker.

A threshold circuit breaker provides property tax relief for the portion of a taxpayer's property tax bill that exceeds a given percentage of income.¹ States may use a single threshold percentage or multiple percentages that rise as income rises.

Under a single threshold circuit breaker, any property tax amount above a specified percentage of income would qualify for relief. Under a multiple threshold circuit breaker, a different threshold percentage applies to different brackets of income. The thresholds apply incrementally, similar to a graduated income tax, to each bracket of income. If the thresholds do not apply incrementally, moving to a higher income bracket would mean the higher threshold would apply

¹Adam Langley, "Estimated Cost and Distribution of State-Funded Circuit Breakers", *State Tax Notes*, April 13, 2009, Vol. 52, No. 2, p.132.

to all of the household's income.² If a \$1 increase in income moved a taxpayer into a higher income bracket, the taxpayer may have a larger reduction in tax relief. This result is referred to the "notch effect".³

A sliding scale circuit breaker reduces property taxes by a fixed percentage within a given income class, with the same percentage reduction in property taxes for all eligible taxpayers within an income bracket, regardless of whether their property tax bill is high or low. Under a sliding scale approach, the tax benefit does not apply incrementally. A small increase in income could result in a disproportionate reduction in the tax benefit (notch effect).

Effects of Circuit Breakers

The threshold circuit breaker is based on the ability-to-pay principle of taxation and can make the residential property tax proportional or progressive over an income range. The threshold approach can provide more benefits to residents of higher-spending jurisdictions than to residents in lower-spending jurisdictions. It also can provide greater benefits to taxpayers living in higher-value homes.⁴

The sliding scale circuit breaker is also based, to a lesser extent, on the ability to pay. It establishes several income brackets, and the relief percentages decline as income increases. All eligible taxpayers within an income bracket receive the same percentage reduction in taxes regardless of how high or low their property tax bills are.

The sliding scale circuit breaker ensures that households share in tax increases so that the increases to the households do not go to zero. Requiring households receiving property tax relief to bear a portion of property tax increases has been variously termed "coinsurance" (Advisory Council on Intergovernmental Relations) or "copayment" (Lincoln Institute of Land Policy). This feature of the sliding scale circuit breaker induces taxpayers to consider the effects of property tax increases on their decision of whether to support the increases.⁵

A copayment from taxpayers can be incorporated into a threshold circuit breaker scheme by rebating less than 100% of the property tax in excess of the threshold.

Montana Property Tax Assistance Programs

Montana provides separate, targeted property tax circuit breakers for low-income property owners, disabled veterans, and elderly homeowners and renters. The state also provides an

²John H. Bowman, et al., "Property Tax Circuit Breakers: Fair and Cost-Effective Relief for Taxpayers", Lincoln Institute of Land Policy, (Cambridge, MA, 2009), p. 16.

³*Ibid.*, p. 34.

⁴John H. Bowman and Michael Veseth, "Property Tax Circuit Breakers: Current Status and Policy Issues", Advisory Commission on Intergovernmental Relations, (Washington D.C., February 1975), p. 3.

⁵*Ibid.*, p. 12.

extended property tax assistance program, under certain conditions, for residential property owners whose residential property has extraordinary market value increases because of reappraisal.

The low-income property tax assistance program (15-6-134, MCA) and the disabled veterans' program (15-6-211, MCA) are sliding scale circuit breakers. Property tax assistance is provided by reducing the tax rate applied to the taxable value of the property. The extended property tax assistance program also provides a reduced tax rate against the market value of eligible residential property (15-6-193, MCA).

The elderly homeowner and renter credit is a multiple threshold property tax circuit breaker (15-30-2337 through 15-30-2341, MCA). Property taxpayers who are 62 years of age or older are eligible for a refundable property tax credit for property taxes paid or the amount of equivalent property taxes paid as rent. The amount of the credit is phased out for taxpayers with income from \$35,000 to \$44,999.

After the staff presentation, Rep. Dick Barrett proposed that the Committee look at a single property tax assistance program that would provide a multiple threshold circuit breaker based on income for homeowners and renters regardless of age.

Sen. Bruce Tutvedt requested information on reducing the notch effect for the property tax assistance program and the disabled veterans' program. Sen. Tutvedt also requested an analysis of reducing the notch effect for the property tax assistance program that was revenue neutral.

At the February 18, 2010, Committee meeting, Larson Silbaugh, Montana Department of Revenue, presented an analysis of each of these requests.

Continuously Increasing Threshold Circuit Breaker

In a memorandum to the Committee on a continuously increasing property tax circuit breaker, Mr. Silbaugh listed the following elements of program design:

- remove differences in the net property tax liabilities of similarly situated taxpayers, regardless of age, homeowner status, or recent change in property values;
- eliminate “notch effects”;
- reduce property tax regressivity;
- simplify property tax assistance programs by consolidating into one program;
- require that beneficiaries pay some portion of property taxes (a co-pay); and
- extend property tax assistance to renters.⁶

Mr. Silbaugh estimated that the new program would cost between \$35.5 million and \$44.2

⁶Larson Silbaugh, Montana Department of Revenue, "A Continuously Increasing Threshold Circuit Breaker", Memorandum to the Revenue and Transportation Committee, April 17, 2010, p. 1. Available at http://revenue.mt.gov/revenue/publicationsreports/legislative_interim_committees/legislative_interim_committee.asp.

million. Eliminating the current programs would save the state general fund about \$10.9 million so the net cost to the state would be between and \$24.5 million and \$33.2 million. Eliminating the tax shift at the local level (\$5.4 million) would result in a total cost to taxpayers of between \$19.1 million and \$27.8 million).

Reducing the Notch Effect Under Existing Programs

In a separate memorandum,⁷ Mr. Silbaugh analyzed the revenue implications of decreasing the notch effect for taxpayers eligible for the low-income property tax assistance program and for the disabled veterans' program.

For the disabled veterans' program, the percentage multipliers were increased by increments of 10 percentage points from 0% to 50% (the current multipliers are 0%, 20%, 30%, and 50%; the lower the multiplier the greater the tax benefit) on incomes between \$42,399 and \$52,999 (inflation-adjusted income figures). The new schedule would increase the statewide property tax benefit by about \$15,400 and reduce state general fund collections by about \$2,700. The remainder of the difference would be shifted to other taxpayers at the local level. An unintended consequence of adjusting the multiplier is that taxpayers within a certain income bracket would experience a decrease in property tax relief.

In a similar manner the percentage multipliers for the property tax assistance program were increased by increments of 10 percentage points from 20% to 70% (the current multipliers are 20%, 30%, and 70%) on incomes between \$10,650 and \$26,625 (inflation-adjusted income figures). The property tax benefit to low-income taxpayers would increase by about \$300,000 and the revenue to the state would decrease by about \$50,000. Under this scenario, no taxpayer would experience a reduction in the property tax benefit.

Mr. Silbaugh also analyzed the effect of reducing the notch effect for the property tax assistance program but maintaining revenue neutrality. The tax rate reduction multipliers would increase from 20% to 90% in increments of 10 percentage points. Under this scenario, two income groups (income from \$17,497 to \$18,638 and from \$22,062 to \$26,625) would experience a reduction of property tax benefits because the tax rate reduction multiplier would be higher for those taxpayers than is the case under current law.

PROPERTY TAX ASSISTANCE OPTIONS FOR COMMITTEE DISCUSSION

There are a variety of options and alternatives within each option that the Committee may consider in providing property tax assistance. Several of those options are described below.

Establish a Continuously Increasing Threshold Circuit Breaker

⁷Larson Silbaugh, Montana Department of Revenue, "Reduced Notch Effects of PTAP and DAV Programs", Memorandum to the Revenue and Transportation Committee, April 17, 2010, p. 1. Available at http://revenue.mt.gov/revenue/publicationsreports/legislative_interim_committees/legislative_interim_committee.asp.

This option would incorporate the features Rep. Barrett's proposal. The proposal would replace the existing property tax relief measures (property tax assistance program, disabled veterans' program, extended property tax assistance program, and the elderly homeowner and renter credit).

The amount of the credit is based on income and property taxes. It is possible that certain taxpayers currently receiving property tax relief would not receive relief under this proposal. The table of examples in Mr. Silbaugh's memo for the disabled veterans' property tax exemption shows that some property owners would not receive credit under this program. However, those examples are based on the top income level within each income bracket and on a residence with a taxable market value of \$100,000. One way around this problem would be to maintain the existing disabled veterans' program and allow a credit for property taxes paid based on the criteria of the proposal.

As noted above, the initial estimated net cost to the state general fund of the proposal ranges from \$24.5 million to \$33.2 million. Mr. Silbaugh listed several ways that costs could be reduced, including:

- increasing the co-pay amount;
- increasing the slope of the threshold;
- increasing the minimum threshold amount;
- reducing the amount of rent that qualifies for the credit;
- capping the credit;
- making the credit nonrefundable; or
- maintaining participation rates of the current programs.

An alternative approach would be to pattern the property tax credit after the elderly homeowner and renter credit. All taxpayers, regardless of age, who meet the income criteria would be eligible for the credit. During the 2007-2008 interim, the Property Reappraisal Subcommittee of this Committee reviewed an analysis of eliminating the age requirement in order to qualify for the credit.⁸ The initial estimate of the cost to the state general fund of expanding the credit was \$17.8 million. Dollar amounts used in computing the credit could be adjusted for inflation (see below under expanding existing programs).

Depending on how the Committee would want to structure the credit under this option, adjustments could be made to the net household income amounts, the income-based property tax limit, the net income percentage amounts, the gross income amounts, the percentage amounts related to the phase-out of the credit, or the cap on the credit.

Reduce Notch Effect Under Existing Programs

⁸See Dan Dodds, Department of Revenue, "Elderly Homeowner/Renter Credit", memo to the Revenue and Transportation Interim Committee, April 17, 2008. The report is available at http://leg.mt.gov/css/Committees/Interim/2007_2008/rev_trans/sub_com/hb488/default.asp under the April 17 and July 10, 2008 meeting dates.

This option would incorporate Sen. Tutvedt's suggestions. This option could take one of two forms. The first would be to expand the number of income brackets to reduce the loss of the property tax benefit as income rises. As noted above, under this option for the property tax assistance program, no taxpayer would experience a loss in the benefit. On the other hand, under the disabled veterans' program, there is an income group that could experience a reduction in the tax benefit by expanding the number of income brackets.

The other form would be to reduce the notch effect under the property tax assistance program but make the change revenue neutral. Under this option some taxpayers would receive less property tax assistance than they do now.

Expand Existing Programs

Property Tax Assistance Program and Disabled Veterans' Program: Additional property tax relief could be achieved by expanding existing programs. Under the property tax assistance program, this could be accomplished by increasing the taxable market value of a residence that would qualify for a reduced tax rate (the current amount is \$100,000) or revising the income bracket or multiplier schedules, or both. The income brackets could be narrowed to reduce the notch effect and the maximum income level to qualify for relief could be increased. The income adjustments could also be considered for the disabled veterans' program. This program does not have a limitation on the taxable market value of the residence in calculating the reduced property tax rate.

Expanding these two programs would shift the tax burden to other taxpayers within a taxing jurisdiction and reduce revenue to the state general fund.

Elderly Homeowner or Renter Credit: In the 2007 legislative session (House Bill No. 236, introduced by Rep. Hal Jacobson) and the 2009 legislative session (Senate Bill No. 179, introduced by Sen. Ron Erickson), legislation was introduced to adjust the dollar amounts used in calculating the elderly homeowner and renter credit. The household income amount, the household income adjustment amount, the income phase-out amounts, and the maximum allowable credit were adjusted for past inflation. The legislation also provided for annual inflation adjustments.

The fiscal note for Senate Bill No. 179 estimated that the cost to the state general fund would be \$8.0 million in fiscal year 2010 and \$8.3 million in fiscal year 2011. An alternative approach would be to forego adjusting the dollar figures for past inflation but provide for an annual inflation adjustment of the current dollar amounts beginning in the tax year in which the legislation becomes effective.

Extended Property Tax Assistance Program: This memo does not offer any specific options for revising the extended property tax relief program. One option may be to provide an income tax credit rather than a reduction in the property tax rate for extraordinary increases in market value. Providing a credit would eliminate the tax shifting within taxing jurisdictions but would impose a cost to the state general fund.

Other Options

At the February meeting of the Residential and Commercial Property Reappraisal Committee, Lee Heiman discussed three types of property tax deferrals: homestead payment deferral, reverse annuity mortgages, and installment payment plans.⁹ Montana enacted a reverse annuity mortgage law in 1989 under Title 90, chapter 6, part 5, MCA.

In 2005, there were 25 states with property tax deferral programs. Property tax deferral programs allow taxpayers (usually over a certain age) to defer taxes until their house is sold, with the government in effect lending them money to pay property taxes. Property tax deferrals could be linked to annual tax increases above a threshold amount or to high property tax burdens.¹⁰

CONCLUSION

The options discussed in this memo involve different approaches to providing property tax assistance and shifting costs to other taxpayers in different ways. The Committee could request bill drafts for one or more options. It could recommend a consensus proposal or several proposals for legislative consideration. The committee is not obligated to make any recommendations under the provisions of House Bill No. 658.

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⁹Lee Heiman, Staff Attorney, "Alternatives for Deferral of Property Taxes", memorandum to the Residential and Commercial Property Reappraisal Subcommittee, February 18, 2010.

¹⁰Andrew Reschovsky, "Got Reform? Property Taxpayers Seek Solutions", PowerPoint presentation, Annual Meeting, National Conference of State Legislatures August 8, 2007, Boston, MA.