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INCREASE SR. CIRCUIT BREAKER

House Bill 4032 (Substitute H-2) First Analysis (4-14-99)

Sponsor: Rep. Alan Sanborn
Committee: Tax Policy

THE APPARENT PROBLEM:

The homestead property tax credit or "circuit breaker" provides taxpayers with an income tax credit for the amount of property taxes paid on their homesteads that exceed a certain percentage of household income. (The credit is called a circuit breaker because a certain level of taxes "trips" tax relief.) Generally, the credit is equal to 60 percent of the amount of property taxes paid that exceed 3.5 percent of household income. However, for senior citizens (and certain specified others), the credit is for 100 percent of the amount by which property taxes exceed 3.5 percent of household income for those with household incomes over \$6,000, and 100 percent of a smaller percentage of household income for those with smaller incomes. The credit cannot exceed \$1,200. Renters can claim the credit by substituting 20 percent of rent for property taxes. Senior citizens who rent can use an alternative calculation if their rent exceeds 40 percent of household income; then, they can claim a credit for the amount by which rent paid exceeds 40 percent of income. The homestead property tax credit is phased out beginning with households earning \$73,650. Households earning \$82,650 or more cannot claim a credit.

Some people believe that the homestead property tax credit should be increased for senior citizens. Advocates say that after years of working and raising families, seniors often face a retirement with reduced incomes but increasing property tax burdens. Some seniors, they say, must give up their homes or face losing them because their taxes outstrip their ability to pay. While Proposal A, the new school financing plan approved by voters in 1994, has reduced school property taxes overall, for some seniors the tax reduction was matched dollar for dollar by reduced property tax credits. (At the same time, the sales tax was increased by two cents.) Proposals to eliminate all or a large proportion of property taxes paid by seniors have been viewed as too drastic, and so compromise legislation to expand the current circuit breaker tax credit has been offered. The household income figures on which the tax credit is based have not been changed since the early 1970's, and with the current healthy condition of the state economy and

state revenues, this is seen as a propitious time to adjust those figures and provide tens of thousands of Michigan senior citizens an expanded property tax credit.

THE CONTENT OF THE BILL:

The bill would amend the Income Tax Act to increase the homestead property tax credit or "circuit breaker" available to a person 65 years of age or older with a household income of over \$6,000. Currently, people in this category can claim a credit for property taxes that exceed 3.5 percent of household income; the bill would calculate the credit using 3 percent of household income. Claimants with household incomes of \$6,000 and below already get an equivalent or more generous credit. (There is a \$1,200 credit maximum and the credit is phased out for claimants with household incomes between \$73,650 and \$82,650.) The bill also would index the \$1,200 cap to inflation; that is, the maximum credit available would increase each year by the same percentage as the U.S. consumer price index for all urban consumers. The bill would take effect January 1, 1999.

Currently, the percentage of household income used in the calculation is based on the following:

For a senior citizen, paraplegic, hemiplegic, or quadriplegic with a household income of \$3,000 or less, 0 percent of household income (meaning 100 percent of property taxes are refundable, up to the \$1,200 limit);

For a senior, etc. with a household income over \$3,000 but not over \$4,000, 1 percent;

For a senior, etc. with a household income over \$4,000 but not over \$5,000, 2 percent;

For a senior, etc. with a household income over \$5,000 but not over \$6,000, 3 percent;

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For a senior, etc. with a household income over \$6,000, 3.5 percent.

House Bill 4032 would alter the calculation by allowing any claimant 65 years of age or older with a household income of over \$5,000 to base the credit on the amount by which property taxes exceed 3 percent of household income.

The term "senior citizen" in the act refers to an individual or one of two persons filing a joint tax return who is 65 years of age or older at the close of the tax year. The term also includes the unmarried surviving spouse of a person who was 65 or older at death. (The bill's provisions apply only to "claimants who are 65 years of age or older.") The term "household income" is defined to mean all income received by all persons of a household, and the term "household" refers to a claimant and spouse. In calculating household income, a claimant begins with federal adjusted gross income and then adds income excluded or exempt from computations of federal adjusted gross income. There are only a few kinds of income excluded from household income.

MCL 206.520 and 206.522

BACKGROUND INFORMATION:

By way of illustration, a senior citizen with a household income of \$10,000 with a property tax bill of \$1,000 could currently claim a credit of \$650. That is derived by subtracting 3.5 percent of \$10,000 (\$350) from the property tax paid (\$1,000). Under the bill, the credit would increase to \$700, by subtracting 3 percent of \$10,000 (\$300) from \$1,000. With property taxes of \$500, the credits would be \$150 and \$200. Similarly, a senior with a \$20,000 household income and the same \$1,000 tax bill could currently claim a \$300 credit, and under the bill would be able to claim a \$400 credit. With property taxes of \$500, a senior with a \$20,000 household income would not be entitled to a credit currently or under the bill.

According to a Department of Treasury report on the income tax issued in September of 1996, more than 1.1 million taxpayers received \$416.5 million in property tax credits in 1995, with \$213.2 million going to senior citizens. The average credit was \$376.79. The average senior citizen credit was \$531.83. The report points out that these totals were reduced from the previous year as a result of Proposal A. Total credits were reduced by \$559.8 million; the overall average credit was reduced by \$190.69; and the average senior credit was reduced by \$274.03. (The 1997 figures, as found in the 1998 Michigan

Taxpayer's Guide, prepared by the Legislative Service Bureau, are similar to 1995: 1.1 million claimants receiving \$432.6 million with an average credit of \$385.)

FISCAL IMPLICATIONS:

The House Fiscal Agency reports that the bill would reduce revenues by about \$43 million if in effect for the entire 2000 tax year. (HFA fiscal note dated 3-24-99) A representative of the Department of Treasury estimated the revenue loss at \$44.5 million annually. (Testimony before the House Tax Policy Committee 4-13-99) The House Fiscal Agency also notes that, "depending on taxpayer behavior, some of the impact may accrue to the School Aid Fund." As explained in testimony by an HFA economist, the School Aid Fund receives a percentage of income tax revenues before refunds and credits, so the bill does not directly affect revenue for schools. The reductions would be in general fund/general purpose revenues. However, senior citizens could alter estimated payments, etc., in anticipation of an increased homestead credit.

ARGUMENTS:

For:

The bill will provide over \$40 million in much-needed property tax relief to Michigan senior citizens. Advocates say that some 400,000 households will benefit. Further, some seniors not now eligible for a tax credit will become eligible. While some people would prefer to eliminate property taxes for senior citizens, this bill instead offers an acceptable, affordable compromise. It reduces senior property taxes without being a budget buster. Supporters of the proposal say that seniors deserve reduced property taxes after a lifetime of paying their taxes while working and raising families. In retirement, seniors often face reduced incomes but increasing property taxes. Some face losing their family homes when taxes outstrip their ability to pay. The household income figures on which the tax credit is based have not been changed for decades, and with the current healthy condition of the state economy and state revenues, this is a good time to provide tens of thousands of Michigan senior citizens more property tax relief. Also, the \$1,200 cap has been in statute for decades. This bill would index that cap for inflation.

Response:

Obviously, there are revenue implications associated with this property tax reduction for senior citizens. This will negatively affect the state budget. Is this wise at this time, coming on the heels of a number of other significant tax reductions? At the least, shouldn't

the implementation of this bill be delayed past the current tax year?

Against:

Property taxes have already been dramatically reduced by the passage of Proposal A in 1994, which greatly reduced local school operating property taxes and, perhaps most significantly, put a cap on how fast assessments can increase from year to year. The assessment cap is essentially reducing property taxes for seniors (and other homeowners) year after year. No longer do seniors who stay in a family home that is increasing rapidly in value face rapid increases in property tax assessments. Assessment increases from one year to the next are capped at five percent or the rate of inflation, whichever is less. The inflation rate in the past few years has been well below five percent. Further, some seniors will benefit from the recent income tax rate reduction, and seniors have benefitted from many of the other tax cuts legislated in recent years. Other kinds of programs, such as tax deferrals and protections from the tax delinquency process can protect seniors from losing their homes because they cannot afford property taxes.

Response:

For many seniors, the reduction in property taxes under Proposal A led to a dollar-for-dollar reduction in the circuit breaker tax credit. So their property taxes were not reduced from pre-Proposal A levels. At the same time, Proposal A increased the sales tax by two cents.

POSITIONS:

The Michigan Assessors Association has indicated support for the bill. (4-13-99)

The Department of Treasury testified in opposition to the bill. (4-13-99)

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.