

STATE OF INDIANA

DEPARTMENT OF LOCAL GOVERNMENT FINANCE
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To: All Taxing Units
From: Melissa Henson, Commissioner, Department of Local Government Finance
Re: HEA 1001-2006, SECTIONS 8-13 (2% Circuit Breaker)
Date: April 25, 2006

SUMMARY OF NEW LAW

SECTIONS 8-13 of HEA 1001-2006 expand the 2% circuit breaker beyond pay 2007 in two phases: (1) the circuit breaker becomes mandatory in all counties for qualified residential property for 2007 pay 2008 and 2008 pay 2009;¹ (2) the circuit breaker becomes mandatory for all types of property in all counties beginning in 2009 pay 2010.²

The “circuit breaker” works by giving a property owner a credit against the person’s property tax liability exceeding two percent of the gross assessed value for the qualifying property.³ The application of the credit results in a reduction of property tax collections of each political subdivision in which the credit is applied.⁴ A political subdivision may not increase its property tax levy to make up for the reduction.⁵ A political subdivision may not borrow money to compensate the political subdivision or any other political subdivision for the reduction of property tax collections due to the credit.⁶

EXAMPLE:

Taxpayer has a qualifying property with an assessed value of \$100,000 before deductions. Taxpayer’s property tax liability is calculated at \$2,100. Two percent of the gross assessed value of taxpayer’s qualifying property would be \$2,000. Thus, taxpayer receives a credit for \$100 , and his tax liability is reduced to the maximum of \$2,000. This results in a reduction of property tax collections by the taxing units in an amount of \$100.

\$100,000 gross AV
x .02 cap

\$2,000 maximum tax liability

\$2,100 calculated taxes due
- \$2,000 maximum tax liability

\$ 100 amount of credit

¹ IND. CODE § 6-1.1-20.6-6.5(b).

² IND. CODE § 6-1.1-20.6-6.5(c).

³ IND. CODE § 6-1.1-20.6-7.

⁴ IND. CODE § 6-1.1-20.6-9.5(b).

⁵ *Id.*

⁶ IND. CODE § 6-1.1-20.6-9.5(d).

EFFECT OF CIRCUIT BREAKER ON TAXING UNIT DEBT

The Department has been asked whether the reduction in property tax collections mandated by the application of the 2% circuit breaker credit in IND. CODE § 6-1.1-20.6-9.5 would affect any funds levied for the payment of debt service or lease rentals and negatively impair bonds and lease financings paid from property taxes in Indiana.

The Department interprets the law to require taxing units to fully fund any funds levied for the payment of outstanding debt service or lease rental obligations or any debt service or lease rental obligations that are approved by the Department under IND. CODE §§ 6-1.1-18.5-8 or 6-1.1-19-8 – regardless of any reduction in collections due to the application of tax credits, including the circuit breaker credit.

Pursuant to IND. CODE § 6-1.1-17-17, the Department will continue to allocate funds for debt service and lease rental payments. Should the funds allocated fail to materialize due to the 2% circuit breaker, taxing units will have to use non-property tax revenues or operating or other funds to offset revenue loss to the debt service fund.

(1) Leases – Political Subdivisions

IND. CODE § 6-1.1-18.5-8 permits any unit of government that has entered into a lease approved by the Department to levy property taxes in an amount sufficient to pay the lease obligations. Upon receipt of the semi-annual property tax collections, the unit is required by law to first set aside an amount sufficient to pay the semi-annual lease rental, and may use the remaining property tax collections along with other revenues to fund its day-to-day operations.⁷

(2) Leases – Public School Corporations

IND. CODE § 21-5-12-9 requires a school corporation that has entered into a lease to annually appropriate and pay sufficient moneys to satisfy its lease rental obligations out of the school corporation's debt service fund. School corporations are also subject to the state intercept mechanism in case of a shortfall.⁸ Therefore, in a case where property tax collections were insufficient to fully fund a school corporation's lease rental obligations, any shortfall would be funded through the intercept program.⁹ However, to avoid application of the intercept program, schools are encouraged to fund any shortfall directly from the school corporation's general fund, which may be used for any lawful purpose, including the payment of lease rental obligations.

(3) Bonds – All Units

⁷ This is consistent with IND. CODE § 5-1-14-9(A) (“The general assembly covenants that it will not adopt, amend, or repeal a statute in a way that impairs the rights and remedies of the owners of obligations, until the obligations, interest on the obligations, interest on an unpaid installment of interest, and all costs and expenses in connection with an action or proceedings by or on behalf of the owners are fully paid and discharged.”).

⁸ IND. CODE § 21-2-21-10(c).

⁹ See also, IND. CODE § 21-2-21-10(d) (“This section shall be interpreted liberally so that the state shall to the extent legally valid ensure that the debt service obligations of each school corporation are paid.”).

IND. CODE §§ 6-1.1-18.5 and 6-1.1-19-8 permit any unit of government that has issued bonded indebtedness approved by the Department to levy property taxes in an amount sufficient to pay the debt service on the bonded indebtedness. Upon receipt of the semi-annual property tax collections, the unit is required to first set aside an amount sufficient to pay the semi-annual lease rental, and may use the remaining property tax collections along with other revenues to fund its day-to-day operations.

CONCLUSION

Taxing units are required by law to fully fund the payment of debt service or lease rentals in an amount sufficient to pay any debt service or lease rentals on outstanding obligations and any obligations that are approved by the Department under IND. CODE §§ 6-1.1-18.5-8 or 6-1.1-19-8 – regardless of any reduction in collections due to the application of tax credits, including the circuit breaker credit. Any reduction in collections must be applied to the other funds of the taxing unit, after debt service or lease rentals have been fully funded.