



Estimated Effects of Indiana's New Tax Reform on the Median Indiana Homeowner and Renter

Revised April 2, 2008

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Introduction

What's the effect of Indiana's new tax reform on the taxes paid by Indiana households? The new laws include property tax cuts and a sales tax increase, so who will pay more and who will pay less is a question.

Policy Changes

Here are the basic changes in state and local taxes that are included in Indiana's new tax reform, which are in House Enrolled Act 1001.

- Remove the school general fund, county welfare funds and a few smaller funds from the property tax, and fund these functions from the state budget.
- Eliminate the existing property tax replacement credits and homestead credits.
- Raise the sales tax rate from 6% to 7%.
- Increase the cap on the existing \$45,000 homestead standard deduction from 50% of homestead assessed value to 60% of homestead assessed value.
- Add a new homestead deduction equal to 35% of assessed value remaining after the existing \$45,000 deduction, up to \$600,000, and 25% of remaining assessed value after that.

- Cap homeowner property taxes at 1% of gross assessed value, rental housing and farm land taxes at 2%, and all other taxes at 3%.
- Raise the ceiling on the income tax deduction for renters from \$2,500 to \$3,000.
- Increase the Indiana earned income credit from 6% of the Federal credit to 9% of the Federal credit.

Under HEA1001, by 2010 the state would take over about \$2.8 billion worth of local property tax levies. The two property tax credit programs would be eliminated, which would free up about \$2 billion to pay for the takeovers. The state would increase the sales tax from 6% to 7%, and some wagering taxes would be redirected, to raise the extra billion. The new sales tax and wagering revenue is a net increase in property tax relief. The added 35% homestead deduction, and the increase in the homestead standard deduction cap to 60%, channels this relief to homeowners.

Homeowner property taxes would be limited to 1% of their gross assessed value, which is the market value before deductions. This is known as the circuit breaker credit. Any taxes over 1% would be erased with a tax credit. Local governments would lose this revenue from their budgets.

Renters are allowed to deduct up to \$2,500 of their rental payments from their Indiana taxable income. Raising this to \$3,000 would reduce their taxable income. The Federal earned income credit is an income tax program that delivers bigger refunds to low-income working people. Indiana's earned income credit is set at 6% of the Federal amount. The proposal raises this credit to 9%.

The changes listed above are what will happen once all the reforms are fully phased in. The circuit breaker caps take full effect in 2010. In 2009 the caps will be 1.5% for homeowners, 2.5% for rental housing and farm land, and 3.5% for all other property. In 2008, 2009 and 2010 the sales tax increase will fund additional homestead credits, even as existing homestead credits are eliminated.

<i>Links to More Information</i>	
To Find:	Go To:
Information about HEA1001 on the General Assembly's website.	Indiana General Assembly, Bill Info (Type "1001" in the "Go To Bill" box)
The Legislative Services Agency Fiscal Note for HEA1001.	This website: HEA1001 Fiscal Note.

Household Incomes, Home Values and Spending

Let's construct a couple of households and see how much they pay in taxes before and after these policy changes. To construct households, we need data.

The U.S. Bureau of Census now conducts an American Community Survey each year, using a sample big enough to give us information about states and some of the larger counties. The most recent data are for 2006. Among the numbers that the survey makes available are household incomes and home values. That's just what we need.

The survey says that the median Indiana home is worth \$120,700. Half are worth more, half less. The median homeowner has an income of \$55,634. The median renter household has an income of \$24,922. Table 1 shows the number of households in each of 98 combinations of income and home values, and 7 income categories for renters.

Table 1

Indiana Home Values and Household Incomes, and Renters and Household Incomes, 2006							
Number of Households in Each Home Value/Income Category							
U.S. Bureau of Census, American Community Survey							
Home Values	Household Income						
	<\$10,000	\$10-19,999	\$20-34,999	\$35-49,999	\$50-74,999	\$75-99,999	\$100,000 up
Value less than \$10,000	4,543	7,843	8,355	5,236	4,434	796	629
Value \$10,000 to \$19,999	3,761	5,943	7,554	4,430	3,779	830	549
Value \$20,000 to \$29,999	3,444	6,819	8,980	3,501	2,890	1,082	635
Value \$30,000 to \$39,999	2,387	6,611	9,583	5,198	4,672	1,207	981
Value \$40,000 to \$49,999	3,709	7,342	13,475	7,124	6,716	1,763	678
Value \$50,000 to \$59,999	3,629	11,587	16,198	11,730	11,365	3,101	1,436
Value \$60,000 to \$69,999	4,960	12,557	21,355	18,752	17,280	5,283	2,060
Value \$70,000 to \$79,999	5,486	13,478	26,931	23,835	26,123	7,765	3,213
Value \$80,000 to \$89,999	5,910	13,914	29,786	26,919	32,595	14,714	5,887
Value \$90,000 to \$99,999	3,619	11,500	25,485	27,956	34,210	15,209	8,160
Value \$100,000 to \$199,999	18,066	34,528	98,702	123,496	226,258	157,693	126,772
Value \$200,000 to \$249,999	2,204	3,622	7,939	13,332	26,615	30,723	47,672
Value \$250,000 to \$499,999	1,938	3,357	7,578	11,622	21,931	23,566	73,230
Value \$500,000 or more	549	818	1,683	1,968	3,711	2,781	22,507
Total Homeowners	64,205	139,919	283,604	285,099	422,579	266,513	294,409
Total Renters	128,114	144,160	174,859	106,209	84,017	25,373	16,214
All Households	192,319	284,079	458,463	391,308	506,596	291,886	310,623
Percent of Households	7.9%	11.7%	18.8%	16.1%	20.8%	12.0%	12.8%

http://factfinder.census.gov/servlet/DatasetMainPageServlet?_program=ACS&_submenuId=&_lang=en&_ts=

The income and home value data provide a starting point for calculating income and property taxes. We need data for sales taxes too. The U.S. Bureau of Labor Statistics' Consumer Expenditure Survey shows how much people spend on 73 categories of goods and services. Table 2 shows some of the data from this survey, for households with three people. These are national average data—no data for individual states is available.

Table 2

Average Annual Income and Expenditures for Three Person Households, 2005-06			
	Average, All Households	\$20,000 to \$29,999	\$50,000 to \$69,999
Income	73,244	25,245	59,449
Expenditures	55,748	30,905	50,598
Food at home	3,967	3,075	4,111
Food away from home	3,173	1,785	3,027
Alcoholic beverages	511	205	450
Tobacco products	392	396	407
Shelter	10,397	6,070	9,010
Utilities, fuels, and public services	3,858	2,940	3,828
Household supplies and furnishings	3,864	1,537	3,170
Apparel and services	2,380	1,815	2,196
Transportation	10,455	6,734	10,250
Healthcare	2,841	1,571	2,829
Entertainment	2,598	1,138	2,337
Personal care products and services	664	311	588
Reading	117	45	101
Education	1,262	436	903
Miscellaneous	921	340	736
Cash contributions	1,688	609	1,238
Personal insurance and pensions	6,659	1,897	5,417

Source: U.S. Bureau of Labor Statistics, Consumer Expenditure Survey, <http://stats.bls.gov/cex/>

Table 2 shows some of the data available from the Consumer Expenditure Survey. The table shows the broader categories of spending. For most of these more detail is available. The average 3-person household, for example, spends \$109 on apparel and services for boys, aged 2 to 15. That spending is included in the apparel and services category. The table shows the averages for all 3-person households and the spending amounts for the income ranges that include the median renter household and the median homeowner household.

A couple of details stand out in Table 2. First, the averages for all households in most categories exceed the averages for the income ranges that include the median renter and homeowner. This is because the very high income households pull the averages for all households higher.

Second, for the lower income households, expenditures exceed income. This implies that the

households must be drawing on savings, or going into debt. Does this make sense?

One explanation is that some households with lower incomes have experienced a temporary reduction in their incomes—unemployment or business losses, for example—and have savings accumulated from their previous higher incomes. Another explanation is that, according to the Federal Reserve’s Consumer Finance Survey, 44% of families with a median income of \$26,000 save some of their income. Of those same families, 70% owe some kind of debt, including 40% who owe on installment loans and 43% who carry credit card balances. Apparently, upper income households save a lot; lower income households save little, draw upon past savings, or take on debt.

The expenditure data is matched with the household income data by estimating “consumption functions” with statistical methods. The results allow the expenditures on each kind of product to be adjusted for income levels in between the averages compiled by the Consumer Expenditure Survey.

<i>Links to More Information</i>	
To Find:	Go To:
An Excel Spreadsheet with the Home Value and Household Income data in Table 1.	This website: Home Value/Household Income data table
The U.S. Bureau of Census, American Community Survey.	Census website: American Community Survey
The Bureau of Labor Statistics, Consumer Expenditure Survey.	BLS website: Consumer Expenditure Survey
The Federal Reserve's Consumer Finances Survey.	Fed website: Consumer Finances Survey

Changes in Tax Payments

The income, home value and sales data of each household can be used to calculate the tax liability of Federal, state and local taxes. Included are the property tax, sales tax, Federal, state and local income taxes, Federal and state excise taxes on tobacco, alcohol and gasoline, the Indiana motor vehicle excise tax, and the Federal Social Security tax. The households are assumed to have three people, two adults and one child, because this is closest to the 2.6 person average household in Indiana.

Table 3 shows the results for the median homeowner and median renter. Tax payments “before” refer to payments under our existing tax system. Tax payments “after” refer to payments with the changes in the new tax reform, HEA1001.

Table 3

Effects of Policy Changes on Median Homeowner and Renter Households						
	Median Homeowner				Median Renter	
	55,634		24,992			
Income	120,700					
Home Value			Dollar	Pct.		
	Before	After	Change	Change	Before	After
Property Tax	1,326	906	(420)	-32%	-	-
Sales Tax	1,200	1,392	192	16%	894	1,034
Income Tax	2,192	2,210	18	1%	693	622
State Excise Taxes	717	718	1	0%	567	567
Federal Income Tax	3,149	3,209	60	2%	(1,638)	(1,638)
Federal Other Taxes	4,661	4,661	-	0%	2,246	2,246
Total Indiana Taxes	5,434	5,226	(209)	-4%	2,154	2,224
Total Taxes	13,244	13,095	(149)	-1%	2,762	2,831

Policy changes based on HEA1001, the 2008 Indiana tax reform.

The median homeowner sees a 32% cut in property tax payments. This amount reflects the decline in the tax rate due to the state takeover of several property tax funds, the increase in the homestead deduction, and the elimination of property tax credits. The Indiana Legislative Services Agency finds that these policy changes cause a 32% reduction in homeowner property taxes overall, so this reduction is assigned to the median homeowner. At state average rates, this amounts to a \$420 drop in the property tax bill.

The homeowner pays an added \$192 in sales taxes, a 16% increase due to the one point rise in the sales tax from 6% to 7%. Federal, state and county income taxes increase, because the median homeowner household itemizes its income taxes. The lower property tax bill means a smaller property tax deduction, a higher taxable income, and so a higher income tax payment, for the Federal, state and county income taxes. Excise taxes rise slightly. With a higher after-tax income the household spends more on tobacco, alcohol and gasoline, which are subject to excise taxes.

Overall, the homeowner household saves \$209 in Indiana taxes, and \$149 in total taxes. For the median homeowner, the property tax reduction exceeds the increases in sales and income taxes.

The renter household, of course, receives no direct property tax cut. (In the long run, rents might be lower because of property tax cuts received by rental housing owners. Research suggests that this probably would not be enough to offset the added sales taxes, though.)

The renter does pay \$139 more in sales taxes. None of the other tax amounts change. The renter household has a negative Federal income tax, because it receives the Federal earned income credit. This credit is “refundable” even if the household owes no tax. The household has no property taxes to deduct, so income tax payments are not affected. The household does not change its spending enough to affect excise taxes much, so the amount rounds to zero.

The median renter household pays \$140 more in sales taxes, because of the sales tax rate increase. The renter household's state income taxes decrease by \$71. Of this amount, \$22 is the result of the \$500 increase in the cap on the renter's deduction, and \$49 is the result of the increase in the Indiana earned income credit from 6% to 9% of the Federal credit.

Overall, the renter pays \$69 more in Indiana taxes and total taxes. For the median renter, sales tax increases exceed state income tax cuts.

So far we've ignored the circuit breaker, which would cap a homeowner's property taxes to 1% of the home's value. The median homeowner's cap would be \$1,207—1% of 120,700--but after the tax rate cuts, added deduction and credit elimination, this homeowner owes \$906 in property tax. The middle-income homeowner at the state average tax rate would not be eligible for the tax cap. Higher valued homes would be eligible for the cap at statewide tax rates, and the median homeowner would be eligible for the cap at above average tax rates.

<i>Links to More Information</i>	
To Find:	Go To:
The Legislative Services Agency tax shift analysis for HEA1001.	This website: LSA Tax Shift memo, HEA1001

Sixty Representative Households

These are just two households. The methods described here can be used for households with any combination of income, home value and spending. Table 4 shows the results of tax change calculations for sixty different households, with income and home values based on the American Community Survey ranges in Table 1.

The shaded cells in Table 4 show the households with small changes in tax bills, of less than \$50. These households are essentially “held harmless.” Households to the “northeast” in the table see tax increases. These are households that are relatively “income rich and property poor.” All renters see tax increases. Those households to the “southwest” in Table 4 see tax cuts. These households are relatively “income poor and property rich.” Retired homeowners on fixed incomes—a group that policymakers are particularly concerned with—are in this

group.

Table 4

**Tax Changes in Dollars for 60 Representative Households
Households with Three People**

		Household Income					
		15,000	27,500	42,500	62,500	87,500	150,000
Home Value	Renter	17	69	144	175	213	297
	15,000	(1)	67	126	164	203	294
	40,000	(66)	2	61	108	148	245
	60,000	(118)	(50)	9	64	104	206
	75,000	(157)	(89)	(30)	31	71	177
	85,000	(183)	(115)	(56)	9	49	158
	95,000	(222)	(154)	(95)	(24)	16	128
	150,000	(508)	(440)	(299)	(267)	(228)	(86)
	225,000	(929)	(862)	(657)	(626)	(586)	(402)
	375,000	(2,145)	(2,078)	(1,691)	(1,659)	(1,620)	(1,314)

Households have two adults under age 65 and one child.

Property, PTRC and homestead rates set at state averages.

Taxes include property, sales, state and local income, excise; Federal income, social security and excise.

Shaded cells show tax changes of less than \$50, increase or decrease.

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The shaded cells divide the table approximately in half, so one might get the impression that nearly half of households see tax increases. This is not correct. Recall that almost one-third of Indiana households own homes in the \$100,000 to \$200,000 range (see Table 1). These households are represented in Table 4 by the \$150,000 home value. All of these households see tax decreases of more than \$50.

In fact, the household numbers in Table 1 can be used to give a rough estimate of the shares of households that see tax increases and tax decreases. The cells in Table 4 that show increases, decreases, or (almost) no change are matched with the numbers of households in each cell in Table 1. Including homeowners and renters, about 57% see tax cuts, 23% see tax hikes, and 20% see only small changes. Among homeowners, 78% see tax cuts, only 8% see tax hikes, and 14% see only small changes. Among renters, 60% see tax hikes, 40% see only small changes, and none see tax cuts.

<i>Links to More Information</i>	
To Find:	Go To:
An article in the <i>Indiana Business Review</i> with further results from this household tax model.	<u>IBR website: The Impact of Property Tax Legislation on Indiana Households, Spring 2008</u>