Public Question 1:

Property Tax Reform in Indiana
1973 through Public Question 1

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Indiana Fiscal Policy Institute

The Indiana Fiscal Policy Institute was formed in 1987 as a private, non-profit governmental research organization. The IFPI is Indiana's only independent statewide source of continuing research into the impact of state taxing and spending policies, and it is privately supported by a variety of organizations, corporations, associations and individuals in Indiana and surrounding states. The IFPI's Mission is to enhance the effectiveness and accountability of state and local government through the education of public sector, business, and labor leaders on significant fiscal policy issues and the consequences of state and local decisions.

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Introduction

Voters on November 2, 2010 approved by a wide margin an amendment to the Indiana Constitution that placed into Article 10 language that gave constitutional status to tax limitation policies already adopted statutorily by the General Assembly. The proposal provided exceptions to the current constitution's requirement of "a uniform and equal rate of property assessment and taxation," principally by allowing for the inclusion of deductions and credits within the power to exempt property from taxation and by providing for a schedule of limits on the percentage of gross assessed value represented by a taxpayer's property tax liability. The language excludes from these limits taxes that are adopted by the voters in a referendum.

Public Question 1 was the latest in a series of attempts to protect homestead property from a major shift of tax burden resulting from assessing property in the state in accordance with the uniform and equal standard of the Indiana Constitution.

Background

The property tax has been the most problematic of Indiana taxes. The tax itself is not the problem; the failure to adopt means of determining an equitable base for the tax is. The base of most taxes is a *flow*—typically, sales and income—for which accurate, up-to-date records of transactions are (or should be) available on a continuing basis against which to measure tax liability. The base of the property tax, on the other hand, is a *stock*—real and personal property—the value of which, in the case of an individual property, may be determined by market transactions only infrequently. In order to assure equitable determination of the taxable value of a parcel of property it is therefore necessary to devise means of estimating the market value in the absence of a recent sale of that property.

The most reliable method of estimating market value is *appraisal*, which involves physical inspection of the property and a subsequent estimate of the projected sales price of the property. Appraisal, however, is an intensive process and, while it may be used periodically to establish benchmarks, less expensive means may be used between appraisals to establish taxable value.

- *Comparable sales.* Most residential properties lend themselves to valuation based on recent sales of comparable properties. Methods of assuring a maximum degree of comparability have been developed by assessors across the nation and, while there may be no perfect substitute for an actual sale,[1] these methods have proved to be quite accurate over time.

- *Capitalization of income.* An income-producing property may be valued by capitalizing the income attributable to that property; that is, converting the rent into

[1] Even an actual sale may not suffice for equitable valuation for tax purposes if, for example, it is not an arms-length transaction, if it is a forced sale or if the method of financing plays a role in the sales price.

present value by using a market-derived capitalization rate.

- *Replacement cost minus depreciation*. Replacement cost is the current cost of constructing a structure equal in utility to the property being assessed using current construction methods and materials. (As contrasted with reproduction cost, which is the cost using materials and methods intended to duplicate the original property.)

Determination of the base of the Indiana property tax had long been characterized by a system administered by 1,008 elected township assessors who typically were not professionals and were subject to reelection. These assessors frequently were more responsive to the demands of election than to professional standards of property assessment, with state oversight that was only rarely able to discipline assessors who violated state standards.

Over a period of time, assessments in Indiana had drifted away from market value to the point at which no real attempt to assess based on "fair market value" or "true cash value" was made. Instead, the standard was "true tax value," a concept unique to Indiana, based on reproduction cost minus depreciation. True tax value was determined by rules promulgated in Title 50 of the Indiana Administrative Code by the State Board of Tax Commissioners. Depreciation was primarily based on the age of the structure, but also on:

- Neighborhood desirability, which was based on "a composite judgment of overall desirability based on the condition of agreeable living and the extent of residential benefits arising from the location of the dwelling."

- Condition, which was to be assessed based on no objective standards.

It also was based on grade, which involved five levels of architectural design (A-E) that afforded assessors several degrees of latitude in coming up with a determination of value.

It was clear that, with no anchor in actual market value, true tax values would not square with constitutional standards of equity or uniformity. With thinly veiled disdain, the Indiana Tax Court assessed the situation as follows:

> In summary, True Tax Value is a figure produced by the application of a closed set of self-referential rules and formulas contained in Title 50. Everything needed to calculate True Tax Value is set forth in Title 50; evidence of value external to Title 50 is irrelevant. As a result, evidence of an improvement's actual reproduction cost or evidence of actual value of land is irrelevant under the True Tax Value system. (*Town of St. John* v. *State Board of Tax Commissioners,* Indiana Tax Court, 690 N. E. 2d 370, 398, Dec. 22, 1997)

In addition, the assessment ratio (the percentage of "true tax value" represented by assessed value) was set statutorily at 33-1/3 percent rather than 100 percent in recognition of the underassessment of property, particularly residential property, in Indiana. Assessed value did not appear to the taxpayer to be connected in any way with the perceived selling price of his/her property.

Finally, reassessment of real property occurred only once every six to 10 years, while personal property was reassessed annually.

1973 Controls

In 1973, during the Bowen administration, the General Assembly adopted a program of property tax limitations. The program reduced property taxes and limited their growth by:

1. Establishing a state Property Tax Replacement Fund to reimburse local units for a 20-percent reduction in property taxes. This was financed by an increase in the state sales tax from 2 percent to 4 percent;

2. Authorizing counties to adopt a local option income tax, the County Adjusted Gross Income Tax (CAGIT), which would replace local property tax revenue; and

3. Freezing property tax *levies* for those counties that adopted CAGIT ("adopting counties") and freezing property tax *rates* for those counties that did not adopt CAGIT ("non-adopting counties").

The 1973 program of property tax limitations had an immediate effect on property tax revenue in Indiana. Between 1973 and 1974, property tax revenue, adjusted for inflation, decreased from $2.917 billion to $2.110 billion, a 27.7 percent decrease. After 1974, real property tax revenue continued to decline, though at a smaller (2.5 percent) average annual rate, until 1981, when they bottomed out at $1.773 billion.

These policies helped to reduce, at least temporarily, the impact of the property tax on taxpayers, but did not address the underlying problems of determining the property tax base.

Legislative Adjustments (1977-1989)

Following 1981, property tax revenues began a period of uninterrupted growth. The resumption of growth was attributable to three statutory changes between 1977 and 1983 that eased the property tax controls of 1973. These changes included:

1. A 1977 amendment that removed the distinction between adopting (CAGIT) and non-adopting counties and a allowed a 5 percent increase in property tax levies in 1978, an 8 percent increase in levies in 1979, and no increase in 1980;

2. A 1979 amendment that allowed civil taxing units (non-schools) to increase their levies on the basis of a three-year rolling average rate of growth in assessed value (Assessed Value Growth Quotient), subject to a 5-percent minimum increase and a 10-percent maximum increase; and

3. A 1983 amendment that removed state Property Tax Replacement Credits (PTRC) from debt service funds, capital project funds, and excessive levies (levy amounts higher than maximum levies) approved by voter referendum for school corporations.

In 1989 the General Assembly adopted legislation shortening the assessment cycle from 10 years to six years and then to four years.

Court-ordered Reforms

The legislative attention paid to the property tax in the 1970s and 1980s failed to address its underlying problems. In 1991, the Indiana Fiscal Policy Institute identified eight problems leading to lack of uniformity and equity in the tax:

- A large number of primary assessing units (1,008);
- Elected assessors at both the township and county levels;
- Assessments that are explicitly not based on market value, but on reproduction cost minus depreciation ("*true tax value*");
- Assessed values at 33-1/3 percent of true tax value;
- Relatively infrequent reassessment of real property but annual assessments of personal property;
- No current means of determining the accuracy or equity of assessments on a statewide basis;
- No requirement for transmitting property sales data to assessors;
- Little consistency in data collection and analysis among assessing units.

IFPI made six recommendations to deal with the problems:

- Reduce the number of assessing jurisdictions by shifting the function from the townships to the counties from 1,008 to 92;
- Provide for appointment of assessors by county executive;
- Strengthen the role of the State Board of Tax Commissioners;
- Adopt market value as the basis for assessed value;
- Change the assessment ratio from 33-1/3 percent of "true tax value" to 100 percent of market value then alter tax rates and debt limits accordingly;
- Continue the trend to shorter assessment cycles.

The IFPI report also questioned the constitutionality of the system in place at the time in light of the requirement in Article 10, Section 1, of "a uniform and equal rate of property assessment and taxation" and a "just valuation for taxation of all property, both real and personal."

***Town of St. John* v. *State Board of Tax Commissioners*.** In 1993 the Indiana Civil Liberties Union brought suit in a case that became *Town of St. John* v. *State Board of Tax Commissioners* alleging that the "true tax value" system was unconstitutional. On May 31, 1996, the Indiana Tax Court published its decision, finding the true tax value system unconstitutional and giving the State Board of Tax Commissioners and the General Assembly until March 1998 to bring the system into conformity with the Indiana Constitution.

Following a series of appeals, the Indiana Supreme Court issued its final judgment in a landmark decision (*State Board of Tax Commissioners* v. *Town of St. John, et al*) on Dec. 4, 1998, in which it determined that the statutory language "true tax value does not mean fair market value. True tax value is the value determined under the rules of the state board of tax commissioners" was constitutional, but affirmed:

> …the Tax Court's determination that the existing cost schedules, lacking meaningful reference to property wealth and resulting in significant deviations from substantial uniformity and equality, violate the Property Taxation Clause of the Indiana Constitution. However, the Clause does not require the consideration of all property wealth evidence in individual assessments or appeals therefrom. It does not mandate the use of strict market value or the use of its three measurement standards. It does not prohibit the use of different assessment methodologies for differing property classifications, or assessment based on value in use, provided that the result is substantial uniformity and equality based on property wealth across all property classifications. (Indiana Supreme Court, *State Board of Tax Commissioners* v. *Town of St. John, et al*, 702 N. E. 2d 1034)

In other words, the statute passed constitutional muster. The implementation of the statute by the State Board of Tax Commissioners, however, failed the constitutional test. The days of true tax value being that as defined by the State Board of Tax Commissioners had come to an end.

Reassessment. The Supreme Court remanded the case to the Tax Court, which then required the State Board of Tax Commissioners to put into effect an assessment system that complied with the Constitution. The deadline for a reassessment of real property was March 1, 2002.

A major aspect of the new system was assessment at 100 percent of "market value-in-use" and utilization of "replacement cost" (as contrasted with "reproduction cost" under the old system) based on data from the Marshall & Swift Assessment Manual, a nationally recognized source. (The previous assessment ratio had been 33-1/3 percent.) The

valuation standard is "[t]he market value-in-use of a property for its current use, as reflected by the utility received by the owner or a similar user, from the property."

Adjustment to the New System. Although a major step toward bringing about equitable assessments had been taken, a legacy of the previous system lingered and created a political problem for policy makers. The old system had worked to the benefit of residential property, particularly older residential property. Equitable assessment would, other things being equal, increase the taxes on *residential property* relative to the taxes on other classes of property.

In 2002, in a special session, the General Assembly adopted a statute (P. L. 192) that, among other things:

- Increased the standard homestead exemption from $6,000 to $35,000
- Required counties to deduct 100 percent of the assessed value of inventory from the property tax base (effective in 2006)
- Permitted counties to levy a County Economic Development Income Tax (CEDIT) for increased homestead credits in order to make up for lost revenues from inventory

This relief for property tax payers was paid for by an increase in the Indiana sales tax from 5 percent to 6 percent.

P. L. 245 of 2003 established a 4-year cycle for general property reassessment (reappraisal) beginning in 2007. The first reassessment under this system was to be completed by March 2009 and would form the basis of taxes levied in 2010. The next reassessment would be undertaken in 2011. The legislation also required the Department of Local Government Finance (which had replaced the State Board of Tax Commissioners on Jan. 1, 2002) to develop a means of adjusting taxable property values ("trending") between general assessments, beginning in 2005.

Constitutional Amendment (2004). The adoption of a large homestead exemption and the elimination of the inventory tax in 2002 raised a question: Was the "equal and uniform" clause of Article 10, Section 1, being violated? To remedy this, the General Assembly placed on the 2004 ballot a proposed amendment to Article 10, Section 1, that permitted the General Assembly to exempt from property taxes:

- A homeowner's primary residence;
- Personal property used to produce income;
- Inventory

The amendment was adopted by the electorate, 71 percent for and 29 percent against.

House Enrolled Act 1478 (2007). HEA 1478 (2007) gave counties expanded authority to increase the County Adjusted Gross Income Tax (CAGIT) and the County Option Income Tax (COIT) by levying additional rates of 1) up to 1 percent to freeze non-school operating property taxes; 2) up to 1 percent to reduce existing property taxes; and 3) up to 0.25 percent for public safety.

House Enrolled Act 1001 (2008). In 2008, the General Assembly passed legislation making several significant changes in the Indiana property tax. HEA 1001 was wide-ranging and no attempt to summarize all of its many provisions will be made here. It did, however, continue to strengthen the property tax assessment process, while coping with the problem of residential property taxation.

First, it eliminated school tuition support levies and increased the state tuition contribution by the amount of the eliminated tuition support levies. It also provided for state assumption of a number of programs previously on the property tax rolls:

- Child welfare
- Juvenile incarceration in state facilities
- State fair and forestry
- Health care for the indigent
- Pre-school special education
- Police and fire pension

To pay for the assumption of these costs, the state increased the state sales tax from 6 percent to 7 percent, used existing gambling revenue, eliminated property tax replacement credits (and the property tax replacement fund) and redirected a portion of the existing sales tax previously used to subsidize local spending.

Second, the new law required referenda for new school and local government capital projects including:

- Elementary and middle school projects more than $10 million.
- High school projects more than $20 million.
- Local government projects more than $12 million or 1 percent of assessed value.

Third, it made significant reforms in the determination of assessed value of taxable property:

- Transferred the primary assessing function from the townships to the counties in all but 42 cases. (Thirty of those 42 were subsequently transferred by referendum.)

- Increased requirements for assessor certification

- Introduced a process for removing assessors that failed to meet standards

- Strengthened oversight of the Department of Local Government Finance

Finally, it introduced certain provisions that are proposed to be embodied in the Indiana Constitution via Public Question 1:

- Placed a set of caps on various classes of property beginning in 2010, expressed as a percentage of gross assessed value:

    - 1% on homestead property (1.5% in 2009)
    - 2% on other residential property (2.5% in 2009)
    - 2% on agricultural land (2.5% in 2009)
    - 3% on other real property (3.5% in 2009)
    - 3% on personal property (3.5% in 2009)

- Made special provisions for Lake and St. Joseph Counties because of their exceptional reliance on property taxes

These last provisions—instituting property tax classifications—raised concerns that they may violate the requirements in Article 10, Section 1, of “a uniform and equal rate of property assessment and taxation.” The concern was not inequitable assessment, but the lack of uniformity in taxation. As a result, a determination was made to place Public Question 1 before the voters to avoid any question of constitutionality and to shield the caps from amendment in future legislative sessions.

Operation of the caps under HEA 1001. If the tax liability for a parcel of property exceeds the levy cap, a tax credit is provided by the county auditor for the difference between the cap and the tax liability, thereby reducing the taxpayer’s liability. This does not affect the taxing unit’s adopted rate and levy, but the county will allocate the credit among all units in the taxpayer’s taxing district in proportion to that unit’s levy, to the total levy of all units in the district. While the budget, rate, and levy for the unit will remain the same, the amount of property taxes received by the local unit will be reduced, which leaves a portion of the budget unfunded.

To cope with this, local option income taxes for property tax relief may be adopted. This will reduce the shortfall of property tax revenue caused by the caps by lowering the levies and rates.

Summary. The problems with the Indiana property tax were recognized for many years prior to 1973. The problems flowed from process that produced assessed values for property that bore only coincidental relationship to the market value of those so most taxpayers did not understand them. Analysts traced this to four problems:

1. infrequent property appraisal;

2. a concept of valuation known as “true tax value,” which was, for residential property, based on reproduction cost minus depreciation as determined by dubious formulas promulgated by the State Board of Tax Commissioners;

3. an assessment ratio of 33-1/3 percent, and

4. administration of the assessment process by 1,008 elected township assessors of widely varying levels of expertise.

From 1973 until 1998 policy consisted largely of attempting to minimize the impact of the property tax by shifting a portion of the burden of financing local government from the local property tax to the state sales tax. This occurred through a system of state property tax replacement credits and to the county option income tax. Although this approach limited the growth of the property tax for a time, it did not address the underlying problems and in 1998 the Indiana courts overturned the system.

Since the *Town of St. John* case, the assessment system has been reformed. The standard is now 100 percent of market value-in-use and reassessments are to occur every four years, with “trending” estimates in the intervening years. Finally, the elected township assessors have been largely replaced by appointed county assessors, with professional certification requirements.

The issue that remains, however, is the impact of equitable reassessment on various classes of properties, notably homestead property. Homestead property previously had been significantly underassessed relative to other classes. Any system of uniform taxation would result in increased taxation of homesteads relative to other classes. This has been addressed by adopting a large homestead exemption (sanctioned by constitutional amendment in 2004), now $45,000, together with a 35 percent supplemental homestead deduction (25 percent for homestead values exceeding $500,000). HEA 1001 took this a step further by adopting a classified schedule of individual parcel levy limits ranging from 1 percent of gross assessed value for homesteads to 3 percent for commercial/industrial and personal property. To assure constitutionality of this approach, Public Question 1 was placed on the Nov. 2 statewide ballot.

Text of the Amendment
(Additions in **bold;** Deletions indicated by ~~--~~)

Section 1. (a) **Subject to this section,** the General Assembly shall provide, by law, for a uniform and equal rate of property assessment and taxation and shall prescribe regulations to secure a just valuation for taxation of all property, both real and personal.

(b) A provision of this section permitting the General Assembly to exempt property from taxation also permits the General Assembly to exercise its legislative power to enact property tax deductions and credits for the property. The General Assembly may impose reasonable filing requirements for an exemption, deduction, or credit.

(c) The General Assembly may exempt from property taxation any property in any of the following classes:
(1) Property being used for municipal, educational, literary, scientific, religious, or charitable purposes.
(2) Tangible personal property other than property being held as an investment.
(3) Intangible personal property.
(4) Tangible ~~real~~ property, including curtilage, used as a principal place of residence by an:
(A) owner of the property;
(B) individual who is buying the tangible ~~real~~ property under a contract; or
(C) individual who has a beneficial interest in the owner of the tangible ~~real~~ property.
~~(b)~~ **(d)** The General Assembly may exempt any motor vehicles, mobile homes **(not otherwise exempt under this section),**airplanes, boats, trailers, or similar property, provided that an excise tax in lieu of the property tax is substituted therefore.
(e) This subsection applies to property taxes first due and payable in 2012 and thereafter. The following definitions apply to subsection (f):
(1) "Other residential property" means tangible property (other than tangible property described in subsection (c)(4) that is used for residential purposes.
(2) "Agricultural land" means land devoted to agricultural use.
(3) "Other real property" means real property that is not tangible property described in subsection (c)(4), is not other residential property, and is not agricultural land.
(f) This subsection applies to property taxes first due and payable in 2012 and thereafter. The General Assembly shall, by law, limit a taxpayer's property tax liability as follows:
(1) A taxpayer's property tax liability on tangible property described in subsection (c)(4) may not exceed one percent (1%) of the gross assessed value of the property that is the basis for the determination of property taxes.
(2) A taxpayer's property tax liability on other residential property may not exceed two percent (2%) of the gross assessed value of the property that is the basis for the determination of property taxes.
(3) A taxpayer's property tax liability on agricultural land may not exceed two percent (2%) of the gross assessed value of the land that is the basis for the determination of property taxes.
(4) A taxpayer's property tax liability on other real property may not exceed three percent (3%) of the gross assessed value of the property that is the basis for the determination of property taxes.
(5) A taxpayer's property tax liability on personal property (other than personal property that is tangible property described in subsection (c)(4) or personal property that is other residential property) within a particular taxing district may not exceed three percent (3%) of the gross assessed value of the taxpayer's personal property that is the basis for the determination of property taxes within the taxing district.
(g) This subsection applies to property taxes first due and payable in 2012 and thereafter. Property taxes imposed after being approved by the voters in a referendum shall not be considered for purposes of calculating the limits to property tax liability under subsection (f).
(h) As used in this subsection, "eligible county" means only a county for which the General Assembly determines in 2008 that limits to property tax liability as described in subsection (f) are expected to reduce in 2010 the aggregate property tax revenue that would otherwise be collected by all units of local government and school corporations in the county by at least twenty percent (20%). The General Assembly may, by law, provide that property taxes imposed in an eligible county to pay debt service or make lease payments for bonds or leases issued or entered into before July 1, 2008, shall not be considered for purposes of calculating the limits to property tax liability under subsection (f). Such a law may not apply after December 31, 2019.

The Effect of Public Question 1

Public Question 1 amended Article 10, Section 1, of the Indiana Constitution to do five things:

1. Provide that language in the section that permits the General Assembly to exempt property from taxation also permits the adoption of deductions and credits.

2. Permit the General Assembly to exempt a mobile home used as a primary residence to the same extent that it may exempt real property.

3. Provide for a classified property tax, with differential limits on the percentage of gross assessed value that may constitute tax liability. The specified classes and limits are:

   - Homestead property 1%
   - Other residential property 2%
   - Agricultural land 2%
   - Other real property (e. g., commercial, industrial) 3%
   - Personal property (other than homestead or other residential) 3%

   These limits are to be effective for taxes due and payable in 2012 and thereafter.

4. Exempt from these limits taxes adopted by voter referendum.

5. Permit the General Assembly to exempt from the limits taxes imposed in an “eligible county” (Lake and St. Joseph) to pay debt service or make lease payments for bonds or leases issued or entered into before July 1, 2008.

Analysis

Public Question 1 is best viewed as one part of a long series of responses, legislative and judicial, to a system of property tax assessment that had permitted taxable property values to become so far divorced from market value that it became constitutionally indefensible. The dilemma faced by policy makers was, and to an extent still is, to reconcile equitable assessments with historic underassessment of residential property so that a new system of equal assessments would not result in a large shift in the property tax burden from commercial and industrial property to homesteads.

The Indiana Constitution requires an “equal and uniform rate of property tax assessment and taxation,” but also permits exemption of “tangible real property, including curtilage, used as a principal place of residence. . .” (homestead). The General Assembly has adopted a $45,000 homestead deduction, a 35 percent supplemental homestead deduction and a $3,000 mortgage allowance, which provide significant reductions in residential property taxes. This was sanctioned by constitutional amendment in 2004.

HEA 1001 of 2008 took this a step further by instituting a series of caps that cover not only homestead property, but all other property, preventing a shift of burden to homesteads, while limiting the liability of other classes of property as well. The possibility that the caps deviate from the constitutional requirement of equal and uniform taxation led to the placement of Public Question 1 on the November general election ballot.

Public Question 1 did not change existing law. Perhaps the most obvious statement that can be made about Public Question 1 is that it did not change the provisions of existing law. It merely assured that the caps in HEA 1001 were constitutional and that a property exemption need not be complete, but may be a deduction or a credit.

Public Question 1 created a specific exception from the constitutional standard of uniform taxation. In drafting Public Question 1, the General Assembly was confronted by two paths. First, it might have simply provided that the General Assembly could make exceptions to the uniform and equal standard, perhaps adding criteria by which to judge those exceptions. Second, it might have chosen a specific exception or set of exceptions to make constitutional. Clearly, it chose the latter route.

Public Question 1 sanctioned a classified property tax system. A common approach to shelter homeowners from the tax burden shifts of a scheme of equitable assessments is to classify property and apply different rates to different classes. This is the approach adopted by HEA 1001 and sanctioned in Public Question 1. By setting different caps on different classes of property, the effective rate in each class is different—lower on homestead property; higher on commercial and industrial property.

Amending the Indiana Constitution

Amendment of the Indiana Constitution is relatively difficult, compared to amendment of other state constitutions. First, the only means of placing a proposed constitutional amendment before the voters is by legislative referral. (Indiana does not have the voter initiative, which has been the means of adoption of a significant number of amendments in the 18 states that have it.) Second, a proposed amendment must receive a majority vote of both houses of the General Assembly in two sessions *separated by an election.* A proposal that makes it through that process is placed on the ballot at the next general election. If approved by a majority of the voters, it becomes part of the Constitution.

The General Assembly passed the first resolution concerning Public Question 1 in 2008 and passed the second resolution in 2010, thereby placing it on the Nov. 2 general election ballot. Voters approved the question 72% to 28%.

An oft-cited problem with a classified property tax system is that it opens the door to inequitable taxation of property not occupied by voters. If voters know that an increase in property taxes will fall less heavily on their residences than on commercial or industrial property, they may feel less inhibited about increasing those taxes, thereby leading to a less attractive tax climate for business.

Public Question 1 did not involve state assumption of the costs of property tax relief as has been the case in the past. Major state initiatives in property tax relief during the last four decades such as property tax replacement credits and homestead exemptions, have been paid for with increases in state taxes. The state sales tax, for instance, has risen from 2 percent to 7 percent in that period. The caps authorized by Public Question 1, however, will

result in lost revenue to local units that may have to be dealt with by local income taxes, expenditure reductions, or increases in the tax base.

The caps sanctioned by Public Question 1 are specific to individual parcels of property, not to taxing jurisdictions. In HEA 1001, the total of any “circuit breaker” credits in a taxing district is the sum of the credits applicable to individual parcels of property, not an overall levy cap on the taxing jurisdiction. These credits are then paid for by reduction in the property taxes of taxing units in the same proportion that their levies bear to the total levy of the taxing district. While this is the current method of paying for these credits, nothing in Public Question 1 mandated this approach.

Public Question 1 continues the trend toward local income taxation. Over time, new local income taxes to replace lost property tax revenue are likely to be attractive to financially-stressed units. Local income taxes have been a growing portion of the Indiana tax structure for many years and in many counties combined state and local income tax rates exceed 5 percent, even 6 percent in a few.

“Circuit Breakers”

Although the term “circuit breaker” is not used in the proposed amendment, the caps are frequently referred to as “circuit breakers,” most notably in material produced by the Department of Local Government Finance. The caps, however, do not fit the definition of “circuit breaker” as it is commonly used elsewhere.

As used in 34 states, circuit breakers are credits against state income tax liability that go into effect when a taxpayer’s property tax bill exceeds a specified percentage of income. They are frequently targeted at senior citizens and low-income residents.

A significant feature of such circuit breaker credits is that they are paid for by the state, leaving local property tax revenues unaffected. The caps in Public Question 1, on the other hand, will reduce property tax revenue to localities.

Public Question 1 exempts taxes levied pursuant to a voter referendum from the limits. Under HEA 1001, referenda are required for the following capital projects:

1. elementary and middle school projects more than $10 million;

2. high school projects more than $20 million, and

3. local government projects more than $12 million or 1 percent of assessed value.

In addition, school general fund levies are subject to referendum.

Public Question 1 simply provides that property taxes “imposed after being approved by the voters in a referendum shall not be considered for purposes of calculating the limits to property tax liability under (the caps).”

This provision does not specify dollar limits or purposes for which the General Assembly might authorize referenda in the future. It could permit adoption of a mechanism for voter approval of significant amounts of property taxation in excess of the caps.

Revenue Impacts

Nature of the caps

The caps limit the property tax liability for individual parcels of property. The overall effect on a taxing district is the sum of the effects of the caps on those parcels. The caps create a classified property tax, with homestead property receiving the most favored treatment, followed by other residential property (largely apartments) and agricultural land, and finally by other real property (largely commercial and industrial). Classification, although common elsewhere, is new for Indiana.

In addition to the caps authorized by Public Question 1, homestead property benefits from a $45,000 homestead deduction, a 35 percent supplemental deduction, a $3,000 mortgage deduction, and other deductions, (e. g., veterans, blind and disabled, and 65 and over). The General Assembly may alter these deductions under the new caps, but it cannot authorize taxes beyond the specified caps unless approved by voters. Given the passage of Public Question 1, should the General Assembly wish to alter these deductions, it would be able to do so, but could not authorize taxes beyond the specified caps unless voter approval were involved.

Operation of the caps

Two provisions of current law serve to limit the impact of the new caps: 1) Deductions for homestead property already reduce homestead taxable values to levels at which the caps provide little or no benefit; 2) Non-homestead property is subject to higher caps and so does not benefit until rates reach $2 or $3 per $100.

The examples in Table 1 show how the caps operate for the various classes of property. A couple of points may be made: First, the current deductions for homesteads already provide substantial property tax relief for that class of property. Because the homestead deductions are fixed amounts as they relate to a specific parcel of property, property tax relief flowing from the levy cap does not exceed current deductions until liability rises to relatively high levels. In the example below, the levy cap does not supply significant relief until the rate reaches $3 and, even then, provides only $118 more in relief than the current deductions.

Second, because of the size of the current homestead deductions, much of the relief that will flow from the caps *per se* goes to non-homestead property. This does not mean that homestead property is disadvantaged by the structure of the caps, it simply indicates that the homestead deductions adopted in prior years already provided a great deal of relief for primary residential property. In addition, most commercial and industrial property is located in urban areas with relatively high property tax rates and will, therefore, come under the caps to a greater degree than it would in other areas.

Table 1
Operation of Caps and Homestead Exemptions

	Homestead(1)	Homestead (2)	Apartment/Agr.	Comm./Ind.
Gross AV	120,000	120,000	120,000	120,000
Homestead Std. Ded.	45,000			
35% Homestead Deduct.	26,250			
Mortgage Deduct.	3,000			
Net AV	45,750	120,000	120,000	120,000
Tax Cap Rate	1%	1%	2%	3%
Tax Cap	1,200	1,200	2,400	3,600
Tax at:				
2.00	878 (1,522)	1,200 (1,200)	2,400	2,400
2.50	1,098 (1,902)	1,200 (1,800)	2,400 (600)	3,000
3.00	1,318 (2,282)	1,200 (2,400)	2,400 (1,200)	3,600

Homestead (1): Operation of current deductions without caps
Homestead (2): Operation of caps without current deductions
Savings from deductions and caps in parentheses.
Source: Lawrence P. DeBoer, Purdue University, and IFPI calculations

Aggregate Revenue Impacts

Table 2 shows the estimated impacts of the caps for each county (except Lake and LaPorte). The average reduction in levy attributable to the caps was 6.3 percent, although the reduction ranged from 22.6 percent in Delaware County and 21.2 percent in Madison County to 0.0 percent in several rural counties. Both Delaware and Madison Counties had relatively high levels of commercial/industrial property subject to the caps. (In many counties the caps provide no property tax relief for commercial/industrial property because of property tax rates below $3.)

Homestead property constitutes more than half of the assessed value of taxable property in Indiana, but receives only 25 percent of the levy cap relief because so much of the value of homestead property is subject to large deductions before calculation of the levy cap. Approximately half of the levy cap relief flows to non-homestead residential property and, to a much lesser extent, agricultural land even though constituting only about 21 percent of total assessed value, the levy cap constituting the principal source of property tax relief for such property. Finally, slightly less than a quarter of levy cap relief accrues to commercial/industrial property, which constitutes nearly a third of total assessed value.

Cnty	County	Levy	1%	2%	3%	Elderly	Total	Circ Brk as % of Levy
2010 Levy Cap Credits								
01	Adams	29,023,561	334,515	746,784	4,376	24,470	1,110,145	3.8%
02	Allen	354,267,822	9,834,495	14,075,631	274,692	446,894	24,631,711	7.0%
03	Bartholomew	83,840,982	1,620,341	1,080,000	265,103	92,775	3,058,218	3.6%
04	Benton	10,968,435	34,195	231,196	6,736	1,342	273,469	2.5%
05	Blackford	10,834,227	98,326	932,579	513,956	10,430	1,555,292	14.4%
06	Boone	72,873,620	2,257,511	359,072	0	5,174	2,621,757	3.6%
07	Brown	10,406,768	0	0	0	139	139	0.0%
08	Carroll	17,535,861	106,445	565,639	215,380	4,500	891,964	5.1%
09	Cass	34,900,626	171,003	2,771,778	2,939,214	33,543	5,915,537	16.9%
10	Clark	102,486,347	404,158	2,830,902	0	114,046	3,349,106	3.3%
11	Clay	14,556,484	367	1,695	0	391	2,452	0.0%
12	Clinton	28,500,062	21,392	1,329,479	887,073	6,630	2,244,574	7.9%
13	Crawford	8,029,151	101,583	790,589	71,744	3,331	967,247	12.0%
14	Daviess	26,046,964	394,565	1,469,235	799,666	16,418	2,679,883	10.3%
15	Dearborn	46,431,480	211,982	424,193	0	697	636,873	1.4%
16	Decatur	21,362,988	36,425	231,806	0	30,275	298,506	1.4%
17	DeKalb	39,221,727	348	582,512	897	26,174	609,930	1.6%
18	Delaware	112,751,060	2,048,163	12,076,609	11,344,148	5,332	25,474,251	22.6%
19	Dubois	40,077,157	401,050	489,463	0	31,064	921,577	2.3%
20	Elkhart	216,486,891	4,216,792	7,316,066	3,347,219	72,422	14,952,499	6.9%
21	Fayette	21,618,092	197,291	1,613,558	1,249,968	60,487	3,121,304	14.4%
22	Floyd	59,580,729	88,940	1,028,190	0	39,518	1,156,648	1.9%
23	Fountain	13,007,907	51,341	304,469	0	7,766	363,576	2.8%
24	Franklin	12,739,479	3,054	0	0	0	3,054	0.0%
25	Fulton	15,603,983	11	59,226	0	5,326	64,563	0.4%
26	Gibson	42,732,823	252,851	1,009,866	276,128	34,902	1,573,746	3.7%
27	Grant	59,627,129	1,008	413,026	948,759	18,420	1,381,212	2.3%
28	Greene	18,908,059	250,614	1,044,472	146,221	23,550	1,464,857	7.7%
29	Hamilton	378,452,275	10,677,931	4,201,795	0	15,334	14,895,060	3.9%
30	Hancock	65,650,563	2,808,466	2,218,416	2,021	33,712	5,062,615	7.7%
31	Harrison	22,058,721	20,241	37,259	579	41,241	99,320	0.5%
32	Hendricks	186,753,981	6,003,748	4,611,741	0	20,890	10,636,379	5.7%
33	Henry	37,556,276	326,148	2,119,312	1,575,349	0	4,020,809	10.7%
34	Howard	95,329,814	5,588	3,710,321	269,216	26,948	4,012,073	4.2%
35	Huntington	32,665,915	457,120	1,236,967	2,108,741	39,731	3,842,559	11.8%
36	Jackson	32,926,976	1,538	229,627	0	29,402	260,567	0.8%
37	Jasper	25,048,517	0	0	0	11	11	0.0%
38	Jay	19,355,379	718	199,157	261,239	19,843	480,956	2.5%
39	Jefferson	26,436,206	321,067	465,599	0	12,158	798,824	3.0%
40	Jennings	19,372,451	106,100	507,554	3,244	27,216	644,114	3.3%
41	Johnson	136,290,092	3,569,019	5,154,675	1,517,990	54,231	10,295,916	7.6%
42	Knox	33,132,401	912,183	2,181,618	2,159,128	654	5,253,583	15.9%
43	Kosciusko	70,835,458	304,364	552,633	0	34,334	891,331	1.3%
44	LaGrange	25,604,256	4,231	130,461	0	5,243	139,935	0.5%
45	Lake	0	0	0	0	0	0	
46	LaPorte	0	0	0	0	0	0	
47	Lawrence	35,929,120	502,595	1,663,839	633,625	10,236	2,810,294	7.8%
48	Madison	121,508,773	2,782,731	4,014,624	18,914,741	22,728	25,734,824	21.2%
49	Marion	1,000,474,773	25,878,885	41,690,591	11,650,315	25,151	79,244,942	7.9%

2010 Levy Cap Credits

Cnty	County	Levy	1%	2%	3%	Elderly	Total	Circ Brk as % of Levy
50	Marshall	39,877,084	181,780	565,315	7,255	15,238	769,587	1.9%
51	Martin	5,752,100	12,092	127,634	20,446	3,664	163,836	2.8%
52	Miami	23,899,952	1,815	1,094,403	985,548	7,723	2,089,488	8.7%
53	Monroe	104,318,986	99,239	0	0	75,152	174,392	0.2%
54	Montgomery	40,534,791	0	1,636,767	985,674	91,115	2,713,556	6.7%
55	Morgan	43,164,346	178	0	0	28,939	29,117	0.1%
56	Newton	15,151,366	36,887	262,901	17,946	14,460	332,195	2.2%
57	Noble	38,114,612	1,715	498,865	0	6,793	507,372	1.3%
58	Ohio	2,116,753	0	0	0	136	136	0.0%
59	Orange	12,020,004	8,350	13,685	0	10,649	32,685	0.3%
60	Owen	13,125,291	21,794	449,676	0	1,872	473,342	3.6%
61	Parke	10,810,564	751	52,785	0	12,524	66,060	0.6%
62	Perry	14,513,138	137,439	772,997	222,476	24,884	1,157,795	8.0%
63	Pike	13,375,669	23,501	271,114	56,871	6,234	357,720	2.7%
64	Porter	185,952,861	1,130,629	2,657,341	0	38,302	3,826,272	2.1%
65	Posey	29,775,533	221,853	346,903	0	7,495	576,251	1.9%
66	Pulaski	10,134,304	0	5,580	0	307	5,888	0.1%
67	Putnam	27,091,235	595	306,552	0	22,152	329,299	1.2%
68	Randolph	21,426,556	188,861	1,202,726	1,086,216	12,808	2,490,612	11.6%
69	Ripley	17,585,519	0	1,357	0	7,554	8,911	0.1%
70	Rush	16,102,042	52,258	862,651	586,984	49,878	1,551,770	9.6%
71	St. Joseph	333,009,064	4,711,442	15,727,809	15,106,015	33,705	35,578,971	10.7%
72	Scott	16,798,871	22,138	645,051	0	10,892	678,081	4.0%
73	Shelby	43,583,404	340,854	761,788	4,763	22,048	1,129,452	2.6%
74	Spencer	21,678,991	14,760	55,824	0	1,677	72,262	0.3%
75	Starke	17,293,729	32,299	319,842	0	2,102	354,243	2.0%
76	Steuben	32,950,619	4,916	6,818	0	3,348	15,082	0.0%
77	Sullivan	18,107,495	45,900	342,495	292,952	8,547	689,893	3.8%
78	Switzerland	5,498,258	2,149	0	0	7,830	9,979	0.2%
79	Tippecanoe	152,110,200	299,992	4,023,126	0	8,992	4,332,109	2.8%
80	Tipton	14,702,831	46,099	339,718	215	15,068	401,099	2.7%
81	Union	6,691,291	53,562	233,179	65,590	858	353,189	5.3%
82	Vanderburgh	170,490,356	988,880	5,227,679	0	22,789	6,239,348	3.7%
83	Vermillion	15,276,662	54,038	479,571	59,615	0	593,225	3.9%
84	Vigo	103,322,875	3,141,438	6,024,944	5,750,218	147,627	15,064,227	14.6%
85	Wabash	23,218,692	0	22,131	0	38,447	60,578	0.3%
86	Warren	7,565,011	3,511	12,499	0	1,894	17,904	0.2%
87	Warrick	47,143,230	245,683	538,310	123,500	2,033	909,526	1.9%
88	Washington	17,821,902	73,755	545,391	233,876	4,380	857,401	4.8%
89	Wayne	64,611,327	1,579,210	3,605,907	300,900	809	5,486,825	8.5%
90	Wells	18,397,469	0	72,836	0	1,376	74,212	0.4%
91	White	24,042,213	42,942	190,337	0	305	233,584	1.0%
92	Whitley	23,348,007	16,279	146,977	0	16,506	179,762	0.8%
	90 Counties	**5,752,307,561**	**91,661,022**	**179,155,702**	**88,294,524**	**2,324,188**	**361,435,435**	**6.3%**

1 percent is net after deductions taken.
Elderly deductions shown for information only.
Source: Lawrence P. DeBoer, Purdue University

LOIT and Caps

Three new Local Option Income Taxes (LOIT) were authorized in 2007. The add-ons to CAGIT and COIT may be up to 1 percent used either to freeze non-school operating property taxes or to reduce existing property taxes. In addition, 0.25 percent may be used for public safety. These taxes have been adopted by 24 counties (17 CAGIT, 7 COIT) and constitute a shift away from property taxes to income taxes.

Table 2 shows that in counties that have adopted one of the LOIT options the reduction in levy from the caps is 8.1 percent as contrasted with 5.3 percent in counties that have not adopted an option.

Outlook

Unlike previous efforts by the state to control local property taxes, the revenue foregone by the operation of the caps will not be made up by state revenues. The impact will fall on local government, which will then have essentially three options: First, turn to local income taxes to make up the lost revenue; second, become more efficient, perhaps making greater use of interlocal cooperation in service provision; and third, adopt means of fostering greater economic growth in local jurisdictions. •

Levy Limitations in the United States

The overwhelming majority of states provide for limitations on the property taxes levied by their local units of government. These limitations vary greatly in their specific detail and in their degree of stringency, but all fall into one of three categories:

1. *Rate limitations.* Rate limitations provide that no more than so many dollars per $100 or so many mills may be levied against property. They may apply to specific types of local units and/or to all local units. Rate limitations are often subject to voter override, at least to a higher limit.
2. *Assessment limitations.* Assessment limitations provide that assessments on property may not increase more than a certain amount, usually a percentage or the change in prices, from one year to the next. Nearly all assessment limitations apply to individual parcels of property and nearly all single out residential or homestead property for favorable treatment. Because changes in property value are not uniform across most taxing jurisdictions, artificially suppressed assessments can lead to inequitable taxation of properties.
3. *Levy limitations.* Limitations on property tax levies are provided for in 28 states, including Indiana. They provide that the levy of a jurisdiction may not exceed some percentage increase, change in prices, or, in the case of Indiana and Ohio, some percentage of assessed value or market value. In practice, levy limitations act as rate limitations because, if the levy is controlled and assessments are permitted to seek their own level, the only remaining factor, the rate, must change to produce the specified levy. (It should be noted that, most levy limitations in other states apply to the total levy of a jurisdiction, with consequent reductions in the rate. Under the approach proposed on the November Indiana ballot, the limits would apply to individual parcels. This means that the net impact on the jurisdiction would flow from the limits as applied to the many individual properties in the jurisdiction.)

Forms of Levy Limitations

Levy limitations across the nation may be placed in six categories. Regardless of the category, levy limitations normally do not apply to levies for debt service or on new construction. They also frequently provide for voter override of the limitation. Finally, they may exclude certain units of local government, such as school districts. The categories are:

1. *Percentage increase*. The most common form of levy limitation is based on a maximum percentage increase from one year to the next. Percentage limitations are often paired with inflationary increase limitations.
2. *Inflationary increase*. Although a few states rely solely on a measure of inflation as the levy limit, the normal approach is to grant inflationary increases as long as they do not exceed a specified percentage limit, for example, five percent.
3. *Rollback*. A variation of the first two approaches, the rollback provides that, following a reassessment, if the levy exceeds a certain percentage or inflationary increase, rates are to be "rolled back" to produce no more revenue than they would have under the allowable increase.
4. *Historical limitation*. Two states provide that levies may not exceed a limit based on actual revenues over the past three years and one state limits the increase to a percentage of inflation over the past three years.
5. *Percentage of assessed or market value*. Ohio and Indiana limit levies to a percentage of market value (Ohio) or assessed value (Indiana). (If assessed value is 100 percent of market value, these should be the same.)
6. *Flat dollar limitation*. One state (Alaska) has a flat dollar limitation on the levy on residential property.

Because of the wide range of limitations and the varying natures of the tax systems of which they are a part, interstate comparison of the impact of these limitations is too broad for the scope of this study.

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