

Public Finance and Budgeting

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December 1, 2009

Impact of House Bill 1001

By

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INTRODUCTION:

It is the government's responsibility to provide certain services to the people they serve. These services are normally funded by way of taxes and/or fees which are collected from the citizens by various methods. Over the past decade Indiana has been involved in a tax revolt to some extent. The way government collects taxes has changed dramatically, leaving many agencies scrambling to try and provide the same services with less revenue or having to cut some services. In this paper I will discuss briefly the history of taxes in Indiana, how Indiana compares to some of the neighboring states and nationally, and finally what impact House Bill 1001 has had on local government – in particular Marion, Indiana.

TAXES IN INDIANA:

Life is full of surprises, but there is an old saying that two things are certain in life – taxes and death. Knowing that government is responsible to provide certain services to its citizens the question must be asked – how do they fund these services? Although all states have different ways of taxing; most include a sales tax, income tax, and property tax.

To decipher and explain how the tax system works in this country is nearly as difficult as understanding rocket science – neither of which I can claim to be an expert. However, I do feel it is important to understand the meaning of sales tax, income tax, and property tax. Therefore, I will give a brief description of each by using definitions found in Jonathan Gruber's book titled *Public Finance and Public Policy*.

Sales Tax – Taxes paid by consumers to vendors at the point of sale.

Income Tax – A tax paid on individual income accrued during the year.

Property Tax – A tax levied on the value of real estate, including the value of the land and any structures built on the land.

Indiana is no different from the other states in that government relies heavily on these three methods of taxation. In his journal, Dr. Faulk (2004) states real property and certain types of personal property are subject to property taxes. He estimates 70 percent of property tax revenue raised in 2002 was raised through tax on real property. Real property includes land and improvements that are permanent. Furthermore, only real property is subject to reassessment and 99 percent of personal property taxes received prior to 2002 was paid by businesses.

Over the past three decades there have been many changes when it comes to Indiana taxes, however, four major events have greatly impacted taxation in Indiana; the Bowen tax package of 1973, the General Assembly changes of 1979, court ordered reassessment of 1993-2000, and House Bill 1001 signed into law in 2008.

The Bowen tax package of 1973 doubled sales tax from 2 percent to 4 percent, permitted counties to levy local option income taxes, set limits on property tax rates, and established tax control boards. This law was passed as a way to control increasing local property tax rates. The package set limits on local government's ability to increase tax levies and provides an alternative means for collecting funds by increasing the sales tax. Moreover, state government now has more responsibility in generating revenues.

In 1979 the General Assembly passed legislation which limited local taxing levies to the same growth rate as the assessed value growth quotient and taxing units were able to appeal to the state board for excess tax levies (Faulk, 2004).

Article 10 Section 1 (a) of the Indiana Constitution calls for a uniform equal rate of property assessment and taxation (Indiana Legislative Services Agency [ILSA], 2004). In 1993 the Town of St. John filed a lawsuit against the State Board of Tax Commissioners arguing the method of assessing true tax value in the State of Indiana could lead to different tax values for property with the same market value, thus violating Article 10 Section 1(a) of the Indiana Constitution. In 1998, the Indiana Supreme Court ruled that property should be assessed “under a system that incorporates an objective reality” to determine the true tax value of a property (Faulk, 2004). Because of the court ruling the State Board of Tax Commissioners implemented a new assessment system in 2001.

Unfortunately, this new assessment system was based on 1999 market values and many home owners experienced dramatic increases in their property tax bills, especially those with well maintained older homes that had been under-assessed for many years.

Adding to the increase in the property tax bills was the change in the inventory tax which had for many years been a major revenue stream for the state. In 2004 Indiana residents voted to eliminate the inventory tax which is a tax charged to businesses on the amount of inventory they maintain. The theory being that by eliminating this tax the state would be able to draw new business into Indiana and would allow existing businesses to put more cash back into the operation of their organization. In his journal Deboer (1999) estimates inventory taxes account for \$395 million of the state’s total tax receipts. Obviously, this shortfall had to be recouped somehow or services would need to be cut. In the end the state would meet the deficit by passing the shortfall onto individual homeowners by way of higher property taxes.

In repealing the inventory tax the Indiana General Assembly authorized counties to adopt a local option income tax (LOIT) to offset the revenue that would be lost with inventory tax

repeal. However, fifty-one counties chose not to adopt LOIT resulting in a dramatic increase in their property tax rate.

If this coupled with the new assessment system was not enough to drive up the property tax bills, in 2006 the General Assembly adopted a refinement to the tax assessment system known as “trending”. Trending required assessors to revalue properties based on their appreciation or depreciation over the period of time between 1999 and 2005. This reassessment resulted in an average property tax increase of 24 percent for most homeowners (Indiana Association for Economic Development [IACED], 2008).

The increased tax burden upon property owners resulted in an outcry from the public to state officials to do something about the rise in property taxes. Most citizens felt as though the assessment of property taxes was unfair and many homeowners found themselves unable to pay significantly higher bills. With increase pressure from the public to do something, in 2008 the General Assembly passed House Bill 1001. This bill is a 4,500 word document which was passed into law during the spring of 2008. The main focus of the bill is an overhaul to the property tax system. Some of the key elements in the bill are an additional \$620 million homestead credit in 2008, \$140 million in 2009, and \$80 million in 2010 (ILSA, 2008). Furthermore, included in the bill is an increase in the state sales tax from 6 percent to 7 percent.

Finally, there are many changes made in this bill, however, the reduction in the amount of revenue generated by the caps placed on property taxes has the most far reaching affect on local government. Especially since local governments receive the bulk of their revenues through property taxes. I will discuss later the impact this bill has had on local government – in particular Marion, Indiana.

COMPARING INDIANA TO OTHER STATES AND NATIONALLY:

If you ask most people about their perception of taxes they are likely to reply they are too high and we pay more taxes than people in other states. Is this statement grounded in facts or is it just their perception? According to a study done by the Institute on Taxation and Economic Policy (ITEP) Indiana residences, on an average, pay less taxes than the surrounding states which include Illinois, Kentucky, Michigan, Ohio, Wisconsin, and Iowa. This study used data from the U.S. Census Bureau and Bureau of Economic Analysis for the fiscal year of 2004. In coming up with final numbers the study expressed as a share of statewide Gross State Product (a measure of all the economic activity in the state), Indiana's taxes were 8.4 percent in 2004, ranking the state as 36th highest nationally and almost 7 percent below the national average. Furthermore, statewide income taxes for Indiana were 10.2 percent or 35th highest nationally and 5 percent below the national average.

Finally, on a per capita basis, Indiana taxes were \$2,994 in 2004, 13 percent below the national average and 30th highest nationally and property taxes were 2 percent below the national average -- ranking Indiana 21st highest nationally.

However, one area of particular concern in the study is that Indiana's state and local tax structure is regressive, meaning it requires low and middle income Hoosiers to pay a higher share of their income in taxes than the wealthiest taxpayers. This is due to the fact Indiana has an across the board 3.4 percent tax on income no matter if your income is \$25,000 per year or \$100,000 per year. Equally, concerning is that everyone pays the same sales tax of 7%, meaning that those in a lower income bracket proportionally spend more of their income on sales and income taxes than those in a higher income tax bracket. It for this reason that typically sales

taxes are seen as a regressive tax, given the lower a family's income the more of its income must be spent on things subject to the tax (ITEP, 2007).

Furthermore, prior to House Bill 1001 the same could be said for property taxes, given the fact the taxes are based on the value of the property regardless of the person's income level and ability to pay. So a person in a low income bracket who may have property, but no job or a low paying job must still pay the assessed property taxes. With this in mind, the debate before and after House Bill 1001, should property taxes be eliminated completely or at least capped at 1%? Both of which require an amendment to the state Constitution.

There is argument both ways on this idea with one side believing that adding an amendment to the Indiana State Constitution capping property taxes at 1% would make it difficult for future Legislatures to raise property taxes, thus ensuring the public receives what they want in lower taxes. Conversely, the other side argues that there may be a need in the future to pay for increases that currently can't be paid for if a 1% cap is in place.

It is generally agreed that a total elimination of property taxes is unlikely since it would cause devastating results to local governments which rely almost entirely on property taxes to fund their budgets. It is estimated that should Indiana eliminate property taxes the state would have to make up for nearly \$6.2 billion by increasing other state taxes (IACED, 2008).

So the answer to the earlier question about how does Indiana compare to other states and nationally; is that generally Indiana residents pay lower taxes than most states around us and even nationally. However, as pointed out in the journal by the Institute on Taxation and Economic Policy some of Indiana's taxes are regressive in nature and add the bulk of the tax responsibility onto the backs of the lower and middle income Hoosiers. Keeping this in mind it really depends on where you fall in the income bracket as to how you feel about taxes in Indiana.

LOCAL IMPACT OF HOUSE BILL 1001:

Generally, speaking the major impact of House Bill 1001 has been on local and county governments. As mentioned earlier the main focus of this bill is to reduce the property tax burden by placing a cap on the tax that can be assessed against property. Most of property taxes generated prior to the bill were passed on to local and county governments who use the money to provide services to their citizens. Outside of some fees charged at the local level the vast majority of local and county funding is through property taxes.

An Indiana Government fact sheet from 2008 shows the breakdown of who spends property tax dollars as follows; schools at 50.5%, county government at 23.2%, cities and towns at 18.9%, libraries at 4.2%, and townships at 3.2%. Furthermore, local governments spend property tax money in the following way; operating 55%, debt repayment 24%, capital 16%, and child welfare 5%. Any changes in the amount of property taxes received by any of these agencies require them to begin thinking about cutting services or looking for ways to better improve their services at a lower cost.

In Grant County the problem was made worse by the fact the county was dealing with already high unemployment before the economic crisis of 2008. In early 2004 the Thomson Consumer Electronics plant employing nearly 1,000 people shut its doors driving the unemployment rate over the 10% margin. Grant County government was already dealing with a budget that was constantly running close to being in the red. According to numbers received from the Grant County Auditor the county budget dropped from \$20,270,284 in 2007 to \$18,676,589 in 2009. Moreover, according to numbers received from the City of Marion Controller the budget for the City of Marion actually fared much better seeing an increase from

\$24,653,508 in 2007 to \$27,021,188 in 2009. However, the numbers are really misleading in that Marion found another way to increase revenue in 2009.

The Mayor of Marion had the foresight to recognize the problem associated with the pending passage of House Bill 1001. He began following the bill when it was first introduced and knew the impact it would have on local government by way of a reduction in property tax money. When it came time to put together the budget for 2009 he informed the City Council and public that the city would need to cut \$ 1.5 million dollars from the city budget or find another way to come up with the money. Recognizing the only way to cut this much money from the budget was by cutting public safety personnel he worked with the council to develop a trash fee, which would offset the revenue loss for 2009. In the fall of 2008 the council agreed, with little opposition from the public, to institute a \$12 per month trash fee.

This was only the tip of the iceberg however as the city was facing a \$2.2 million shortfall for 2010 and perhaps as much as \$800 thousand for 2011. The picture for the county was just as dark with both governing units realizing they would need to cut more personnel -- which would equal less service being provided to the public.

Fortunately, included in the passage of the bill is the option for counties to adopt a local option income tax (LOIT) and to increase the local tax by 0.25 percent to pay for public safety. To adopt the LOIT a majority of the councils in the county had to approve the ordinance and they had to approve it either with or without the increase for public safety. In other words one council could not approve it with the public safety increase and others approve it without the public safety increase. In the fall of 2008 the County Council passed an ordinance to adopt LOIT without the public safety increase, however, a majority of the other councils did not approve the

LOIT, citing they wanted more time to study the impact on citizens and to get a better understanding of just how much of a decrease in property tax money they could expect for 2010.

In 2009 the Marion City Council surveyed the citizens of Marion to see what services they were willing to see cut in the following year. The number one area that nearly all those surveyed said they did not want to see cut was public safety – with police ranking as number one and fire directly behind. Equally as clear though was the fact they did not want to see a new tax, meaning the 0.25 increase for public safety had little chance of approval. No elected official wants to be the one responsible for passing a new tax. Furthermore, the economy had deteriorated even more with the local unemployment rate over 12%. To add a new tax onto those who were already suffering would be political suicide.

To the Mayor and council it had become clear that Marion was going to lose over \$3 million in 2010 and more in 2011. The plan for dealing with this loss was to cut ten fire positions and ten police positions for 2010. With this in mind they had no other option but to pass the LOIT at 1% without the 0.25% public safety increase. The other councils followed by passing the same ordinance prior to the July 1st deadline. However, even with passage of LOIT there was going to be a shortfall in the city's budget. In the end the Mayor and City Council agreed to cut \$2.2 million dollars from the 2010 budget by eliminating 21 jobs including four firemen and four police officers. Some of the job reductions came as people retired and jobs were not filled. In the case of the four police officers the jobs were saved when the police department was successful in obtaining a Federal Stimulus grant to pay for the four positions for the next three years.

Certainly the effect of House Bill 1001 could have been much worse in Marion had it not been for the insight of Mayor Seybold who recognized the future impact this bill was going to

have on local government. Many local and county governments across the state are making enormous cuts to their upcoming budget which means a reduction in the workforce and likely a change in the services provided to their citizens.

CONCLUSION:

Major changes in the Indiana taxing system began in 2001 after an earlier court ruling found the system to be unfair. Nearly the same time Hoosiers voted to do away with the inventory tax causing even more of a shift in the property tax burden to the individual home owner. Because of rising property tax bills, that many could not pay, the General Assembly was faced with doing something to ease the burden on the individual homeowners. The result of nearly a decade of increasing property taxes was House Bill 1001. With this bill the General Assembly changed local and county budgets across the state. For years citizens have become accustomed to a certain level of service from their local government. The passage of this bill did not change their expectation, but is certain to change the service they receive. They want their services to remain the same but their taxes to decrease.

Hoosiers are very fortunate in that we pay lower taxes than most of our neighbors and other fellow Americans; however that does not mean we can't do better. Unfortunately, many of the taxes we do pay are regressive and hurt the lower to middle income people. I am not one who subscribes to spreading the wealth around. I believe the American dream is to work hard, provide for your family, and not rely on the government to provide everything to me. Although, with that being said, I do believe the system we have in place must be fair across the board. House Bill 1001 has impacted every Hoosier. How much of an effect and what will be the consequences will be something we may not know for years to come. Government must do a better job at finding ways to cut waste and provide the basic services which each citizen is entitled to receive.

Every level of government from Federal to local must work together to find a taxing system that is fair to all. Conversely, we as citizens must realize that government cannot and should not be relied upon to provide us everything.

I believe most Americans recognize that we must pay taxes to keep many of the services we currently receive. However, I also believe they are fed up with governmental waste when it comes to their tax dollars. For many of us who work in local government -- House Bill 1001 is bitter-sweet. It greatly reduces the revenue we have to work with but at the same time requires us to look in-ward to see where we can become more efficient.

As I mentioned early on in this paper to understand the taxing system in Indiana and in the United States is nearly as difficult as understanding rocket science. We must somehow work together to develop a system which is easier to understand and is fair to those at all levels of income.

Without a doubt something needed to be done to fix the property tax issue in Indiana, unfortunately I believe the state simply decided to pass the problem onto local governments who had little recourse but to raise local taxes or cut services. It is my opinion both state and local officials should have done more to work together on fixing this problem. In the end it is the citizens who lose again.

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