Policy Matters Ohio

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Targeting homestead exemption would save Ohio $118 million a year

Targeting the expansion of the property tax exemption proposed by Gov. Ted Strickland would save the state at least $118 million a year, while directing the same or greater tax reductions to low- and moderate-income Ohioans who most need property-tax cuts. Those were among the conclusions of an analysis by the Institute on Taxation and Economic Policy that was released today by Policy Matters Ohio.

ITEP, a nonprofit, nonpartisan research group in Washington, D.C., with a sophisticated model of the state and national tax systems, examined the governor's proposal, which has been approved with modest changes by the state House of Representatives. It also analyzed two alternatives. One would restrict the proposed exemption to low- and middle-income Ohioans, while the other would expand the current homestead exemption. It found that in either case, at least $118 million would be saved annually.

The tax changes approved by the Ohio General Assembly in 2005 already are significantly undercutting state revenues while transferring income to the most affluent Ohioans. "Ohio can ill afford untargeted tax cuts," said Dr. Jon Honeck, Policy Matters research analyst. "We should limit the exemption to those who most need it. The additional revenue freed up by a more targeted homestead exemption could be used in a variety of ways to provide vital services and make investments in Ohio's future." The revenue gain could go, for example, toward funding parent Medicaid coverage at 100 percent of the poverty line, other vital social services, and additional investment in all levels of education to provide opportunities for Ohioans.

The Homestead exemption and the Strickland Plan

The current homestead credit is available to senior citizens 65 and over and totally disabled individuals with low incomes. The credit amount is determined by deducting a certain amount from the taxable value of the home, and multiplying it by the gross millage rate. The reductions in taxable value are greatest for those with low incomes, as shown in Table 1 below.[1] Both the income levels and the taxable value amounts are adjusted for inflation each year. Based on the statewide gross millage rate of 84.2, a recipient in the lowest income bracket would receive a final credit amount of $479.94 ($5,700 x .0842) under current law in 2007. An individual in the highest income bracket would receive $95.15 ($1,130 x .0842).

Table 1. Homestead Credit Reductions in Taxable Value, 2007

Income Level	Reduction in Taxable Value -- Lesser of --
$0 – $13,800	$5,700 or 75%
$13,801 – $20,300	$3,500 or 60%
$20,301 - $27,000	$1,130 or 25%

Source: Legislative Service Commission, HB 119 bill analysis

According to the Ohio Department of Taxation, 220,525 senior homeowners received a total of $70.1 million credits in 2004.[2] The average exemption amount was $3,920, indicating that most of the recipients were either in the lowest or middle income brackets.

Gov. Strickland's proposal would eliminate any income requirements for the homestead exemption. It would provide a local property-tax exemption on the first $25,000 of market value (or $8,750 of taxable value) for all homeowners 65 or older and for permanently and totally disabled homeowners. The average annual tax savings for those who are not receiving a credit now would be approximately $400. The state would reimburse local taxing authorities for the loss of revenue.

The plan would expand eligibility to all senior homeowners, who number about 800,000, but would not provide significant additional tax savings to some of the poorest homeowners who currently receive a homestead credit. As measured against the tax year 2005 homestead credit, ITEP found, 43 percent of the total savings would go to homeowners with incomes of $50,000 or above, even though they comprise only 35 percent of elderly homeowners. Just 1 percent of the additional tax cuts would go to the 11 percent of senior homeowners with incomes below $15,000 a year. For those in this group, the average annual savings would be $31. The amount is so small because for some of the lowest-income homeowners, the current exemption would be more generous than the new exemption in the governor's plan. To protect against this, Strickland's proposal includes a "hold-harmless" provision so that no one would receive a smaller tax reduction because of the new plan.

[1] The current exemption is calculated on a dollar amount or as a percentage of the taxable value of the home, whichever is less. Because of the growth in home values, most recipients receive the credit based on the dollar amount rather than the percentage reduction in total taxable value.

[2] Ohio Department of Taxation, *2006 Annual Report.* Real Property. Table 7: Number of Homestead Exemptions Granted, Average Reduction in Taxable Value, and Total Reduction in Taxes, By County, Tax Year 2004, p. 149.

Under the governor's plan, senior homeowners with incomes between $15,000 and $30,000 would see an average net tax savings of $290. The overall statewide tax savings averages $325, taking into account that some homeowners will not receive additional benefit under the plan.

The state's ability to finance tax cuts out of regular tax sources is severely limited. According to the Ohio Office of Budget and Management, state tax cuts approved two years ago will reduce General Revenue Fund revenues by $502 million in FY2008 and more than $2.2 billion by FY2011, compared to a baseline statutory sales tax rate of 5.0 percent. A significant share of these tax cuts is going to the most affluent Ohioans. Because of this revenue situation, the governor's proposed expansion of the homestead exemption would be paid for largely with the savings on interest from debt Ohio would not issue because of a securitization of its settlement with the tobacco companies. However, it would also require a portion of two utility taxes to be used as well. The Ohio Department of Taxation has estimated that both sources of support together would still fall short of fully funding the expanded exemption in eight of the next twenty years.[3]

Two Alternatives to the Strickland Plan

ITEP modeled two major alternatives to the Strickland plan. One plan imposes an income eligibility limit of $40,000 on the Strickland plan, and the other increases the credits and the income limits of the existing credit so that they are worth the same as they were in 1980, in inflation-adjusted terms. Table 2 below spells out some of the basic results of this analysis. The analyses use the current homestead exemption as a baseline.

Table 2. Eligibility and Costs of Alternative Plans

PLAN	Eligible Homeowners	Additional Cost vs. Current Credit	Cost Savings vs. Strickland Plan
Strickland Plan with $40,000 income limit*	440,000	$116 million	$144 million
Index Existing Credit to 1980 Levels	401,000	$142 million	$118 million

Source: ITEP
* Includes hold harmless provision, so that existing recipients of the exemption receive at least as much as they do now

According to the ITEP analysis, limiting the homestead exemption proposed by Gov. Strickland to those with annual incomes under $40,000 would cost an additional $116 million per year, compared to the $260 million in the governor's proposal. Yet the exemption would still apply to 440,000 elderly homeowners, about twice the number receiving the existing homestead exemption, and over half of the elderly homeowner population. By limiting the exemption, 64 percent of the gain would go to those with

[3] "Projected Annual Cash Flow of Expanded Homestead Exemption Proposal," Ohio Department of Taxation, first cited in "Tobacco Money Plan Debated," *The Columbus Dispatch*, May 27, 2007, by Mark Niquette and Jim Siegel

incomes between $15,000 and $30,000. Nearly all of the rest would go to those with incomes between $30,000 and $40,000.

Alternatively, ITEP found that expanding the current homestead exemption so it provides the same coverage as the exemption did in 1980 would cost an additional $142 million a year, or $118 million less than the governor's plan. This would mean increasing the income threshold for the exemption so that elderly and disabled homeowners would qualify if their incomes were below $36,750. It would also mean boosting the value of the maximum exemption to $12,250 of a home's taxable value. That compares with the current $5,700 maximum exemption, which is available only to those with incomes under $13,800 (see Table 1 above). This maximum would amount to $35,000 in market value, providing a larger exemption than the $25,000 in the Strickland plan.

Table 3. Homestead Credit Reductions indexed to 1980 Value

Income Level	Reduction in Taxable Value
$0 - $13,400	$12,250
$13,401 – $24,500	$7,350
$24,501 - $36,750	$2,450

Source: ITEP. This table shows the impact of this option if it were enacted in 2006. If this proposal were enacted in 2007, these numbers would be adjusted upward.

Under this proposal, the 11 percent of Ohio senior homeowners who earn less than $15,000 a year would average a reduction of almost $500, or 4.7 percent of their annual income. This group would receive 31 percent of the additional tax reduction. Fully 60 percent of the additional tax reduction would go to those with incomes between $15,000 and $30,000, a group that accounts for 31 percent of senior homeowners. Their average tax reduction would be $336. This plan would also simplify the existing homestead exemption by eliminating a feature under which the exemption may be calculated using a percentage of the home's taxable value.

Like the Ohio Office of Budget and Management estimates, ITEP's analysis covers only senior homeowners, not those who are disabled. In Franklin County, slightly over 12 percent of the 11,000 individuals who received a homestead exemption for property listed on the 2006 tax rolls were disabled, according to the Franklin County Auditor's office. This adds some uncertainty to the estimates and raises the possibility that actual costs under any of these plans may be higher if all of those who are eligible apply.

Policy Matters Ohio (www.policymattersohio.org) is a nonpartisan, nonprofit research institute with offices in Cleveland and Columbus. ITEP's Microsimulation Tax Model allows it to measure the distributional consequences of federal and state tax laws and proposed changes in them, both nationally and on a state-by-state basis. A description of the tax model can be found on ITEP's web site, www.itepnet.org.