LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 7158 **DATE PREPARED:** Jan 19, 2000
BILL NUMBER: HB 1364 **BILL AMENDED:**

SUBJECT: State and local finance.

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FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: ***State Expenditure Limit*:** This bill limits increases in state expenditures to the lesser of the percentage increase in inflation and population or 6%. It allows voters or two-thirds of the members of the General Assembly to authorize additional spending. The bill provides that if revenue exceeds the spending limit for that state fiscal year, the excess shall be refunded in the next state fiscal year except as to an amount that a majority of the voters agree to apply toward an increase in allowable spending.

***Inventory Tax*:** Beginning in 2002, this bill provides a credit against a taxpayer's state tax liability for property taxes paid on inventory, phased in over five years.

***Welfare Levies*:** Beginning in 2002, this bill eliminates the remaining property tax levies for public welfare (the Family and Children's Fund levy, the County Medical Assistance to Wards [MAW] levy, the county Hospital Care for the Indigent [HCI] levy, and the Children with Special Health Care Needs levy).

***School General Fund*:** The bill also eliminates the authority of a school corporation to impose a General Fund property tax levy for the general operation and maintenance of the school corporation beginning in 2006 and provides a property tax replacement credit for school General Fund property taxes in 2002 through 2005. The bill provides a method for calculating the amount of miscellaneous taxes distributed to school corporations.

Effective Date: July 1, 2001.

Explanation of State Expenditures: ***Expenditure Limits:*** This bill establishes a maximum annual percentage change for state government expenditures to be the lesser of 1) inflation plus the percentage change in Indiana population or 2) 6%. If revenues exceed the expenditure limit, the excess shall be refunded in the next fiscal year except an amount that a majority of the voters voting in a general election agree to apply toward an increase in allowable spending. The General Assembly may also authorize spending that exceeds the expenditure limit if a joint resolution is adopted by two-thirds of the members of both the House and Senate. This resolution may apply to only one fiscal year.

The bill allows individuals to file a lawsuit to enforce the state expenditure limits. Successful plaintiffs are allowed costs and reasonable attorney fees. The state may recover costs and reasonable attorney fees if a suit is ruled frivolous.

Revenue collected, kept or spent in violation of this statute for four fiscal years preceding the date the lawsuit is filed shall be refunded with ten percent annual simple interest commencing for each fiscal year on the date the state exceeds the spending limitation.

The state may use any reasonable method to refund revenues which are in excess of the spending limits including temporary tax credits or rate reductions. Refunds do not need to be proportional when prior payments are impractical to identify or return. Refund methods are also subject to judicial review.

This bill applies to appropriations beginning in FY 2002. According to December 15, 1999 Surplus Statement, FY 2001 budgeted appropriations are $10,052.3 M. The average annual inflation rate for the last five calendar years has been 2.4%. The growth in Indiana resident population has been less than 1% over the last ten years. Depending on the level of inflation and growth in population in 2001, FY 2002 expenditures could be restricted to less than a 3.4% increase. The current Revenue Forecast also projects a 5% increase in General Fund and Property Tax Replacement Fund revenue from FY 2000 to FY 2001. There is no official forecast of revenue collections for FY 2002 and beyond.

The impact on state spending and the amount of revenue which would be available for refund is subject to legislative, executive and judicial actions.

Background Information: The annual change in the CPI and growth in the Indiana resident population for the last five calendar years are identified below. The maximum increases in the expenditures are also estimated to reflect what would have occurred if these limits were in placed from CY 94 to CY 98.

Calendar Year	% Change CPI	% Change in Pop	CPI + Pop
CY 94	2.59%	.7%	3.29%
CY 95	2.83%	.8%	3.63%
CY 96	2.95%	.7%	3.65%
CY 97	2.29%	.6%	2.89%
CY 98	1.56%	NA	NA

Inventory Tax Credit: The Department of State Revenue will have additional administrative expenses associated with the revision of tax forms, instructions, computer programs and compliance to accommodate this credit.

***Welfare Levies*:** This bill eliminates the remaining county funding of welfare and children's services. (HEA 1001-1999 removed the property tax levies for the County Welfare Fund and the County Welfare Administration Fund and transferred funding responsibility to the state.)

Beginning in CY 2002, the state would be responsible for the current gross county expenditures for welfare and children's services which are estimated at $172.9 M for FY 2002 (½ year), $353.9 M for FY 2003, and $370.7 M for FY 2004. Child welfare expenditures experienced an average annual increase of about 20% between 1987 and 1995. The projections, above, are based on estimated continued growth in child welfare expenditures of about 5% per year reflecting the lower annual increases of the last few years. Also, average growth rates are based on the previous five years for the other funds.

The State already contributes to this expenditure in the form of property tax replacement credit (PTRC) and homestead credit. Because of the elimination of the gross property tax levies under this proposal, the state payment for PTRC and homestead credit would be reduced by about $30.3 M for FY 2002 and $62.1 M for FY 2003, and $65.2 M for FY 2004.

The net additional state expenditures (additional expenditures less PTRC and homestead credit) are estimated at $142.6 M for FY 2002, $291.8 M for FY 2003, and $305.5 M for FY2004.

The estimated net cost broken down by fund is presented in the following table.

Estimated Net Cost for State Takeover of Welfare Funding (In Millions)							
Fund	CY 2002	CY 2003	CY 2004		FY 2002	FY 2003	FY 2004
Family & Children	225.4	236.0	247.1		112.7	230.7	241.6
HCI	44.4	46.5	48.7		22.2	45.4	47.6
MAW	9.5	10.0	10.6		4.8	9.8	10.3
Children with Health Needs	5.8	6.0	6.1		2.9	5.9	6.0
TOTAL	**285.1**	**298.5**	**312.5**		**142.6**	**291.8**	**305.5**

School General Fund**:** Under current law, the State pays property tax replacement credits (PTRC) in the amount of 20% of the school General Fund levies, with some exceptions. Since this bill abolishes school General Fund property tax levies beginning in CY 2006, the state would no longer have a PTRC obligation for these levies under this proposal. PTRC on school General Fund levies is estimated at $413 M in CY 2006 and $431 M in CY 2007. State homestead credits would also be reduced by the elimination of school General Fund levies. State homestead credit on school General Fund levies is estimated at $35 M in CY 2006 and $36 M in CY 2007.

The total reduction of state expenditures under this provision is projected at $448 M in CY 2006 and $467 M in CY 2007 or $224 M in FY 2006 and $457 M in FY 2007. Both PTRC and state homestead credit are paid from the Property Tax Replacement Fund which is annually supplemented by the State General Fund.

Under this proposal, the General Assembly declares that sufficient tax revenues and distributions would be provided to school corporations each year beginning in CY 2006 so that each corporation would receive at least as much revenue as it did in the previous year. Based on the estimated CY 2005 statewide school General Fund gross levy, the minimum replacement revenue would amount to approximately $1,988 M. This amount, reduced by the savings from the current PTRC and state homestead credit obligations results in a net guarantee of approximately $1,540 M for CY 2006 and $1,521 for CY 2007. By fiscal year, the net guarantee is estimated at $770 M for FY 2006 (½ year) and $1,530 M for FY 2007.

ADDITIONAL PROPERTY TAX REPLACEMENT CREDIT

Under the provisions of this bill, the State would be required to provide additional PTRC on school General Fund levies beginning in CY 2002 and ending in CY 2005. The following table illustrates the amount that the State would be required to distribute in addition to current PTRC obligation under State law:

CALENDAR YEAR	**PERCENTAGE OF SCHOOL G.F. LEVY**	**ADD. PTRC AMOUNT**
2002	20%	$350 M
2003	40%	$731 M
2004	60%	$1,143 M
2005	80%	$1,590 M

The additional PTRC would amount to approximately $175 M in FY 2002, $541 M in FY 2003, $937 M in FY 2004, $1,367 M in FY 2005 and $795 M in FY 2006.

STATE GENERAL FUND SUMMARY TABLES

The following table illustrates a fiscal year projection of the impact to the State General Fund regarding the additional PTRC provision of this bill, as well as the potential State impact regarding the school General Fund guarantee provision of this bill.

Additional PTRC Impact to State G.F.
School G.F. Guarantee (In Millions)

Fiscal Year	**Additional PTRC Impact to State G.F.**	**Net School G.F. Guarantee**

FY 2002	$175	
FY 2003	$541	
FY 2004	$937	
FY 2005	$1,367	
FY 2006	$795	$770
FY 2007		$1,530
FY 2008		$1,511

Explanation of State Revenues: ***Inventory Tax Credit:*** This bill creates a business inventory tax credit based on a certain percentage of property taxes paid on inventory. The applied percentages and corresponding tax years are identified below along with the estimated revenue loss for the respective fiscal years.

Tax Year	% Credit	Estimated Inventory Tax Credit (M)	FY Impact
2002	20%	$45.0 M *	FY 2002
2002	40%	$136.9 M	FY 2003
2003	60%	$239.1 M	FY 2004
2004	80%	$356.5 M	FY 2005
2005 & After	100%	$432.7 M	FY 2006 & after

* Due to the effective date of January 1, 2002, it is expected that taxpayers will adjust their quarterly payments in 2002 to reflect the amount of inventory taxes paid in 2001. Therefore revenue collections for the last six months of FY 2002 will be affected.

The credit may be taken against the taxpayer's liability under the Corporate Gross Income Tax, Adjusted Gross Income Tax, Supplemental Net Income Tax, Insurance Premium Tax, and the Financial Institution Tax. If the amount of the credit exceeds the taxpayer's liability, they may carry the excess over to the following taxable years. They are not entitled to a refund of any unused credit and the credit may not be carried back to prior taxable years.. If a pass through entity does not have an income tax liability, the credit may be taken by the shareholder(s) or partner(s) in relation to their distributive income in which they are entitled from the pass through entity.

The tax credits would continue to grow in tax years 2006 and years after. Tax revenue from the various taxes noted above are deposited in the General Fund and the Property Tax Replacement Fund.

Explanation of Local Expenditures: ***Welfare Levies*:** The counties will experience reduced expenditures for welfare and children's services at an estimated $345.8 M for CY 2002, $362.1 M for CY 2003, and $379.3 M for CY 2004.

<u>Explanation of Local Revenues:</u> ***Welfare Levies*****:** The counties will experience reduced net levies of an estimated $256.2 M for CY 2002, $268.9 M for CY 2003, and $282.3 M for CY 2004.

The reduced net levies, above, are equal to the reduced gross levies less the amount paid by the state for PTRC and homestead credits. The gross levies are estimated to be $316.8 M for CY 2002, $332.5 M for CY 2003, and $349.1 M for CY2004. PTRC and homestead payments are estimated to be $60.6 M for CY 2002, $63.6 M for CY 2003, and $66.8 M for CY 2004.

In addition to the elimination of the welfare funds and the shift in responsibility to pay for welfare and children's services, the FIT and Motor Vehicle Excise Tax monies that were apportioned to the welfare funds can now be used for other purposes within the county. The estimated total revenues that are freed up for these two taxes are about $29.0 M for CY 2002, $29.6 M for CY 2003, and $30.2 M for CY2004.

Tax increment financing (TIF) allocations are equal to the incremental assessed value in a TIF area multiplied by the taxing district's tax rate. As a consequence of eliminating these welfare and children's services levies and tax rates, TIF proceeds would be reduced. If the tax rates had been eliminated in CY 1999, TIF districts, statewide, would have lost about $5.9 M. However, this bill permits the TIF district's governing body to impose a special assessment on the property in the TIF area in order to meet the district's obligations.

School General Fund**:** This bill eliminates the property tax levy for school General Funds beginning in the year 2006. Statewide, school General Fund gross levies are estimated at $2,073 M in CY 2006 and $2,162 M in CY 2007.

The bill also eliminates the County School Distribution Fund and the Supplemental School Operating Reserve Fund in Lake County and the County School Distribution Fund in Dearborn County. The levy for the Lake County School Distribution Fund amounted to $3,523,173 in 1999 and the Dearborn County levy was $564,318. Schools in these counties would lose this revenue under this provision. The Lake County Supplemental School Operating Reserve Fund is not currently in use.

Although this bill eliminates school General Fund levies for the general operation and maintenance of the school corporation, it would allow school corporations to continue to levy a school General Fund property tax for certain public libraries, nursery schools, historical societies, art associations, public playgrounds, and the Indianapolis Children's Museum.

Beginning in CY 2006, school corporations that successfully appeal to the School Property Tax Control Board could receive emergency relief from the state in the form of grants, loans, authority to borrow money, advances, permission to use unobligated balances in a construction fund, or any combination of these items.

The total amount of reduced property tax levies under this provision amounts to approximately $2,076 M in CY 2006 and $2,165 M in CY 2007. However, the funding guarantee mentioned in State Expenditures provides school funding in some form at a minimum of previous year school General Fund levels.

Under current law, counties that impose the County Option Income Tax (COIT) may provide a locally funded homestead credit of up to an additional 8%. It is estimated that in CY 2006, school corporations will receive $46 M in COIT homestead revenue to replace school General Fund levies. COIT revenue that is not used to supplement local homestead credit is distributed to counties, cities, and towns. Therefore, the $46 M that school General Funds will receive in CY 2006 under current law would instead be distributed to counties, cities, and towns as a result of this bill.

Under current law, counties that impose the County Adjusted Gross Income Tax (CAGIT) allocate local property tax replacement credits to civil taxing units and to school corporations. It is estimated that in CY 2006, school corporations will receive $33 M in CAGIT revenue to replace school General Fund levies. CAGIT revenue that is not used to replace school General Fund levies is distributed to counties, cities, towns, and to other school funds. Therefore, the $32 M that school General Funds will receive in CY 2006 under current law would instead be distributed to counties, cities, towns, and to other school funds as a result of this bill.

Under this proposal, a tax increment financing (TIF) area would have the ability to place a special assessment on property in the allocation area if the elimination of the school General Fund property tax rate affects the TIF area's ability to repay obligations. The amount of the assessment would be limited to the difference between the total revenues available to pay the obligations and the total amount due on obligations entered into before April 2, 2005.

This bill provides an alternate method for calculating the amount of Financial Institution Taxes and Auto Excise Taxes to be distributed to school corporations after the elimination of the school General Fund property tax. The new calculation will ensure that the school General Funds will continue to receive Financial Institution Taxes and Auto Excise Taxes in the same amounts as they do under current law.

The additional PTRC paid in school General Fund levies in CY 2002 - CY 2005 would reduce property taxpayers' net tax liabilities. The amount of reduction would be equal to the school General Fund Gross levy times 20%, 40%, 60,%, and 80% respectively in those years. Total school General Fund revenues in CY 2002 - 2005 would not be affected by this provision.

State Agencies Affected: Family and Social Services Administration; Department of State Revenue, State Tax Board.

Local Agencies Affected: Counties; School Corporations

Information Sources: Family and Social Services Administration; Local Government Database; U.S. Census Bureau; Bureau of Labor Statistics.