Fiscal Research Program

AN ANALYSIS OF THE BARNES AND MILLNER PROPERTY TAX RELIEF PROPOSALS

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FRP Report No. 22
October 1998

Georgia State University

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ISSUE ANALYSIS

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Executive Summary

Roy Barnes and Guy Millner have each proposed using state funds to reduce property taxes on homeowners. Both proposals are relatively straight forward.

Barnes proposes adding a new homestead exemption of $20,000, which would be in addition to the existing homestead exemptions, and would be phased in over time. The state would reimburse local governments for the loss in property tax revenue. Millner proposes an income tax credit equal to 20 percent of a homeowner's property taxes, up to a maximum credit of $500.

The cost of these two proposals differ. We estimate that the Barnes proposal, when fully phased in, will cost the state government between $610 and $630 million per year, while the Millner proposal will cost between $300 and $320 million per year. However, there are uncertainties regarding the two proposals that when determined could change the cost estimates of the proposals.

The distribution of the tax reduction differs between the two proposals. The Millner proposal provides greater dollar tax relief to homeowners with higher-valued property and to those living in jurisdictions with higher property tax rates (i.e., millage rates). The percentage reduction in property taxes, however, would be the same for all homeowners.

The Barnes proposal provides greater dollar relief to homeowners in jurisdictions with higher property tax rates, but the same dollar relief for all homeowners within a jurisdiction regardless of property value. The percentage reduction in property taxes falls with increasing property value.

For those homeowners who itemize their deductions for federal and state income tax purposes, 30 to 40 percent of the property tax reduction in either plan will be offset by an increase in income taxes.

There are several administrative issues that arise, but none very serious. There will be some additional costs at both the state and local levels associated with administration and monitoring eligibility for both proposals. The Barnes proposal calls for the state to reimburse local governments for the loss in revenue due to the higher homestead exemption; there is some degree of uncertainty that the state will always be able or willing to adhere to this reimbursement.

Both proposals provide incentives to purchase larger housing and to switch from renting to owning. The proposals reduce the differences in property taxes between jurisdictions, and thus, reduce the incentive to live in lower-tax jurisdictions. Since the state government would be paying part of the cost of

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providing local public services, there is an incentive for voters to demand more local public services. The effects of these incentives are not likely to be very large.

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Introduction

Both Roy Barnes and Guy Millner have proposed using state government funds to finance a reduction in local property taxes. The following analysis provides a comparison of the two proposals. The version of the proposals reviewed here were taken from the issue page of the web site for each of the two candidates, with clarification of some aspects obtained from the candidates' offices.

Description of the Proposals

Barnes Proposal. Roy Barnes proposes adding a new homestead exemption of $20,000, which would be in addition to the existing local homestead exemptions for which a homeowner is eligible. The homestead exemption would be phased in over 7 to 8 years. The new homestead exemption would be state-funded, i.e., the proposal calls for local governments (school districts, counties, municipalities, etc.) to be reimbursed by the state for the loss in revenue due to the higher homestead exemption.

Millner Proposal. Guy Millner proposes the provision of a credit on the Georgia income tax equal to 20 percent of taxpayer's property tax payments on homes. The maximum allowable credit is $500.[1]

Box 1 on page four illustrates the calculation of property taxes and how the two proposals would affect property taxes paid. There are many details that would have to be spelled out for each proposal before any legislation could be written, and before a complete analysis can be performed. However, there are two aspects of the proposals that are uncertain and that are important for our evaluation of the proposals. The two issues are:

- Under the Barnes proposal it is not clear what the magnitude of the reimbursement to local governments will be for homes that have an assessed value that is less than the total allowable homestead exemptions (local plus the new exemption). As displayed in Box 2 on page five, the reimbursement in such a situation depends upon whether the new homestead exemption is added on top of the current local homestead exemption, or if the local homestead exemption is added on top of the new homestead exemption. Since a substantial percentage of homesteaded property will have assessed values less than the total of the homestead exemptions, this is an important issue in determining the level of reimbursement, i.e, the cost of the proposal. Note that in either approach, the property tax paid by the homeowner is the same, although with a larger reimbursement from the state, the local government could lower property taxes.

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Box 1. Property Tax Calculation

Example: Assume that the home has a fair market value of $100,000, that the standard homestead exemption is $2,000, and that the property tax rates are 22 mills for operations and 2 mills for bond payments.

Assessed value is 40 percent of fair market value, or $40,000 for our example.

Net assessed value is the assessed value less the homestead exemption, or $38,000.

Property tax rates are expressed in **mills**, where one mill is one dollars of tax per $1000 of value. Expressed as a percentage, a property tax rate of 22 mills would be 2.2 percent.

Property taxes for operations are based on net assessed value, while property taxes for bonds are based on assessed value (no homestead exemption is allowed). In our example property taxes for operations are 2.2 percent of $38,000 (= 0.022 times $38,000, or 22 mills times $38), i.e., $836, while property taxes for bonds are 0.2 percent of $40,000 (= .002 times $40,000, or 2 mills times $40), i.e., $80. Total taxes are thus $916 (= $836 + $80).

Barnes Proposal

Under the Barnes proposal, the homestead exemption go to $22,000. Thus, the tax calculation is:

$100,000 times 40% = $40,000

Deduct $22,000 = $18,000

Calculate tax:
Operations: $18,000 times 0.022 = $396
Bonds: $40,000 times 0.002 = $80

Total Tax: $476

Property Tax Reduction: ($916- $476) = $440

Millner Proposal

Under the Millner Proposal, property taxes paid do not change. Instead, in the following year, the homeowner determines his or her Georgia income tax liability as before. But in addition, the home owner calculates 20 percent of the property taxes paid on the home. For our example,

20% of $916 = $183.20

The Georgia income tax liability is then reduced by $183.20.

Georgia Income Tax Reduction = $183.20

• The Millner proposal calls for the income tax credit to be refundable. A refundable tax credit allows a taxpayer to receive money back from the state if the credit reduces the income tax liability below zero. In other words, with a refundable credit, if the income tax liability before the property tax credit is $100 and the property tax credit is $150, then the state would forgive the income tax liability and would in addition pay (refund) the taxpayer $50. Such a refundable income tax credit was passed by the General Assembly in 1994, but was vetoed by Governor Miller after the Attorney General ruled that the refund would constitute a gratuity and hence be unconstitutional. Millner, however, claims that the proposal does not violate the Georgia Constitution. The determination of the constitutionality of the refundable part of the credit, which will likely have to be made by the courts, will affect the cost of the proposal.

Box 2. The Effect of Alternative Application of Proposed Homestead Exemption

To see how the effect of the proposed homestead exemption on the reimbursement to local governments depends upon whether the new homestead exemption is added on top of the current local homestead exemption, or if the local homestead exemption is added on top of the new homestead exemption, consider the following. Suppose that the millage rate is 30 mills, that the local homestead exemption is $13,500, and the assessed value of the home is $25,000 (i.e., a market value of $62,500.)(For reference, note that property taxes would be $750 if there were no homestead exemptions.) First consider the case in which the new homestead exemption is added on top of the existing local homestead exemption. Without the new homestead exemption, property taxes would be $345 (= ($25,000 - $13,500)*30 mills), i.e., the $13,500 homestead exemption saves the owner $405 (= $750 - $345). With the addition of the new $20,000 homestead exemption, property taxes go to zero, saving the owner $345. Thus, $345 is rebated to the local governments.

Now consider the reverse, i.e., the local homestead exemption is added on top of the new homestead exemption. Without the local homestead exemption, but with the new $20,000 homestead exemption, property taxes would be $150, which would be a saving of $600 (= $750 - $150). Thus, the reimbursement to the local governments would be $600. (The addition of the local $13,500 homestead exemption would reduce property taxes to zero.)

The question is whether the reimbursement to the local government will be $345, i.e., the tax saving if the $13,500 homestead exemption is applied first, or $600, which is the tax saving if the $20,000 homestead exemption is applied first. Since a substantial percentage of homesteaded property will have assessed values less than the total of the homestead exemptions, this is an important issue in determining the cost of the proposal.

There are four issues addressed in this report:

- who benefits;
- what is the cost to the state government;
- what are the administrative issues, and;
- what are incentive effects.

Who Benefits and How

Under each proposal, only homeowners would receive a property tax reduction.[2] This would include any owner occupied housing and the immediately surrounding land, and would include homes on family owned farms. There are several classes of property that would not be eligible, including, rental property, commercial property, industrial property, agricultural property, public utilities, and personal property.

There are various types of homeowners who would not benefit, or not benefit fully from one or the other of the proposals:

- Owners who do not take a homestead exemption would not benefit. To benefit from the Barnes homestead exemption, an owner must have applied for a homestead exemption. An owner would also likely be required to have applied for a homestead exemption as proof of eligibility for the Millner property tax credit. It is reported, but not documented, that some homeowners do not apply for homestead exemptions, either out of ignorance or of fear that it might lead to closer inspection of the home by tax assessors or building code inspectors.

• Neither proposal would benefit homeowners who currently pay no property tax, e.g., because the assessed value is less than the current homestead exemption. In Atlanta, for example, no taxes are paid on homes with market values less than $37,500, while in Muscogee County no taxes are paid on homes with market values less than $33,750. In addition, in Muscogee County, the taxable value of homesteaded property equals the original purchase price, not the current fair market value. Thus, for example, a $55,000 home that has been owned by the same person for several years may have a value of just $30,000 for tax purposes. No local property taxes would be due on this home.

• If the courts rule that Millner's income tax credit cannot be refundable, then there will be some homeowners who pay property taxes who will not benefit, or benefit fully from the Millner proposal. In particular, homeowners with low taxable incomes are not likely to benefit, or not benefit fully since these households have little or no income tax liability against which to claim the credit. The bulk of this group would be comprised of the elderly with incomes from pensions and other non-taxable sources of income. Other than the elderly, most low-income households are renters.

For those who will benefit from either proposal, the magnitude of the property tax reduction will depend upon the value of the property and the property tax rate faced by the owner. Table 1 illustrates how the benefit will vary by property value and by property tax rate. For the Barnes proposal, we show the tax cut for the first year (assumed to be 1/8th of the fully implemented value) and for the fully-implemented proposal.

The Millner proposal provides greater dollar property tax relief to those homeowners with higher valued property and those living in jurisdictions with higher millage rates. The percentage reduction is the same for all homeowners, provided that the owner is below the $500 cap. The Barnes proposal provides greater dollar relief to homeowners in jurisdictions with higher millage rates, but the same dollar relief for all property within each jurisdiction, regardless of property value. The reduction in property taxes as a percentage of property taxes currently paid falls with increasing property value under the Barnes proposal, but obviously is 20 percent for everyone under the Millner proposal unless the $500 cap is reached.

Both the Barnes and Millner proposals offer more dollar relief to homeowners living in jurisdictions with higher millage rates; jurisdictions with higher millage rates are more likely to be found in urbanized areas. Relative to the Barnes proposal, the Millner proposal would benefit owners of higher-valued property (subject to the cap of $500) more than owners of lower-valued property. Relative to the Millner proposal, the Barnes proposal would benefit owners of lower-valued property more than owners of higher-valued property. Owners of higher valued property tend to be households with higher income and those living in more urbanized areas.

The Millner proposal has a cap on the income tax credit of $500, and thus only the first $2,500 in property taxes are subject to the credit. (See Case J in Table 1.) If the millage rate is 26.6 mills, which is about the state average, and the local homestead exemption is $2,000, the property taxes on a home with a market value of $240,000 will be $2,500. Thus, on average, only homeowners with homes worth more than $240,000 (a small proportion of all homeowners) would not be eligible for the full amount of the credit. The value of the home at which the $500 cap would be reached does depend on the millage rate. For example, if the millage rate is 20 mills, the $500 cap would apply to homes worth more than $317,500, while if the millage rate is 40 mills, the $500 cap would apply to homes worth more than $161,250.

To the extent that individuals itemize their deductions for federal income tax purposes, the reduction in property taxes will result in an increase in federal taxes that the owner has to pay. For homeowners in the 31 percent income tax rate bracket who itemize deductions, each $1.00 of property tax reduction will result in a $0.31 increase in federal taxes because of the lost of a dollar of deductions.

Costs of the Two Proposals

We developed estimates of the cost to the state government for each of the two proposals.

Millner Proposal. We estimate that the Millner proposal will cost $300 to $320 million, assuming that the income tax credit is fully refundable.[3] The $500 cap does prevent some homeowners from obtaining very large credits, but the effect on the cost of the program is small — about 3 percent.
If the courts rule that the credit cannot be refundable, then some of the potential credit can not be used, i.e., if the income tax liability is less than 20 percent of the taxpayer's property tax, then the taxpayer could not claim the entire credit. We are unable to estimate the magnitude of this effect, but we estimate that the maximum reduction in the cost of the proposal because of a non-refundable credit is 9.6 percent, although we believe the reduction in cost will be much less than that.[4]

Barnes Proposal. We estimate that the Barnes proposal, when fully implemented, will cost between $610 to $630 million per year. This estimate assumes that the new homestead exemption is added on top of the existing homestead exemption; and thus, the state will only reimburse the local governments for the reduction in property taxes beyond the existing homestead exemption. As was noted above, homesteaded properties with a net assessed value that is less than $20,000 cannot take full advantage of the $20,000 homestead exemption (Cases A and B in Table 1). The above estimate of the cost of Barnes' proposal adjusts for this effect.[5]

Administrative Issues

There are several administrative issues that arise for the two proposals. The Millner proposal allows homeowners to claim a credit on their state income tax return, which would require a minor modification of the income tax forms. The state may want homeowners to provide evidence of the eligibility of the taxpayer and of the property taxes paid. This could be accomplished by requiring the taxpayer to submit a copy of the property tax bill (under the assumption that the bill was paid). If the property tax bill is currently sent to or paid by a third party, e.g., a mortgage company, county tax commissioners will have to send out a tax bill to the property owner. If the state requires proof of the payment of the property tax, then county tax commissioners will have to prepare and mail an additional form to the homeowner that would then be included with the income tax return. A further complication is that the property tax bill may also include charges (sanitation services, for example) that are not property taxes. Thus, the homeowner could not simply claim an income tax credit for the total amount paid to the local governments.

The Barnes proposal will require the calculation of the reduction in property taxes resulting from the new homestead exemption for each taxing jurisdiction in the state. If the tax assessor's office is not computerized, or has a very primitive system, then it may not be particularly easy for the tax assessor to do this. From the local governments' perspective, the biggest issue with respect to the Barnes proposal is providing a guarantee that the state will always reimburse the local governments for the loss of revenue due to the higher homestead exemption. Regardless of what is stated in the legislation, it is always possible that the General Assembly will decide at some time in the future that it cannot afford to finance the $20,000 homestead exemption; thereby reducing the level of reimbursement to local governments without reducing the homestead exemption.

The two proposals will require an increase in expenditures for state administration. The state will have to hire additional staff and develop processes to either administer the credit or to monitor the rebates to local governments.

Incentive Effects

There are at least three possible incentive effects, although the magnitude of the incentive effects are not known. First, a reduction in property taxes makes homeownership more attractive relative to renting. Thus, we could expect some increase in the homeownership rate, although the effect would likely be very small given that property taxes are only part of the cost of homeownership.

Second, with the reduction in property taxes, the importance of property taxes to the residential location decisions will be reduced. Consider Cases C and D in Table 1, i.e., homes with a taxable value of $40,000, and assume that the two cases represent two jurisdictions, one with a 20 mill property tax rate and one with a 30 mill property tax rate. In the absence of the two proposals, the difference in property taxes between the two jurisdictions is $400. The Millner proposal reduces that difference to $320, and when fully implemented the Barnes proposal reduces the difference to $200. The reduction in the difference makes the higher tax jurisdiction a somewhat more appealing (or less unappealing) place to live, and may entice some homeowners and businesses to move into the higher tax jurisdiction. There is no empirical evidence that allows us to estimate the magnitude of this effect, although there is empirical evidence suggesting that property owners do take property taxes into consideration in deciding residential location.

The third incentive effect relates to the level of public expenditures at the local level. Both proposals reduce the cost that the local taxpayers have to pay for public services. In the absence of any funds from other governments, local taxes of one dollar have to be collected in order to spend a dollar on public services. Under the two proposals, the state pays part of the cost. The reduction due to the proposals is partially offset by an increase in income taxes due to the reduction in itemized deductions.

Under the Millner proposal, the typical local homeowners would only have to pay $0.86 for each dollar of property tax raised. In effect, Millner's proposal will cut the cost of an additional dollar of public expenditures financed through the property tax by 14 percent. Under the Barnes proposal, the effect depends upon the value of the home (see Table 1). Assuming a house value of $75,000 and an existing $2,000 homestead exemption, the $20,000 homestead exemption would reduce the cost of public expenditures financed from property taxes to only $0.61, which is a 39 percent reduction.

Empirical estimates of the effect of a 10 percent reduction of the cost of expenditures to taxpayers is to increase expenditures by about 2 percent. The implication is that the Millner proposal will increase expenditures by 2.8 percent. For the Barnes proposal, the effect depends on the house value and millage rate, but for the example given above, the implications is that the proposal would increase local government expenditures by 7.8 percent. (Property taxes are not cut for all voters, e.g., renters, and thus, the effect may be smaller than suggested here.)

Summary and Conclusions

Both of the two proposals are relatively straight forward ways of reducing property taxes on homeowners. The two proposals differ in terms of who benefits the most, the cost to the state, and the administrative aspects. The one issue not addressed is the financing of each proposal. The easy answer is that the increase in state revenue will be sufficient to finance either proposal. However, using new state revenue does mean either that the state will forgo programs and services that would otherwise have been funded, or that the state will forgo cutting other taxes.

Table 1. Examples of Property Tax Savings Under the Two Proposals

	Case A	Case B	Case C	Case D	Case E	Case F	Case G	Case H	Case I	Case J
Property Value	$30,000	$30,000	$55,000	$55,000	$105,000	$105,000	$205,000	$205,000	$255,000	$255,000
Taxable Value*	$10,000	$10,000	$20,000	$20,000	$40,000	$40,000	$80,000	$80,000	$100,000	$100,000
Millage Rate	20 mills	30 mills	20 mills	30 mills	20 mills	30 mills	20 mills	30 mills	20 mills	30 mills
Property Tax	$200	$300	$400	$600	$800	$1200	$1600	$2400	$2000	$3000
Property Tax Reduction:										
Millner's Proposal										
Dollars	$40	$60	$80	$120	$160	$240	$320	$480	$400	$500
% of taxes paid	20%	20%	20%	20%	20%	20%	20%	20%	20%	16.7%
Barnes Proposal (1st year)										
Dollars	$50	$75	$50	$75	$50	$75	$50	$75	$50	$75
% of taxes paid	25%	25%	12.5%	12.5%	6.25%	6.25%	3.125%	3.125%	2.5%	2.5%
Barnes Proposal (fully implemented)										
Dollars	$200	$300	$400	$600	$400	$600	$400	$600	$400	$600
% of taxes paid	100%	100%	100%	100%	50%	50%	25%	25%	20%	20%

* Calculation assumes a local homestead exemption of $2000 and there is no bond millage rate.

Endnotes

1. Millner has also proposed eliminating the property tax on motor vehicles. That proposal has been analyzed in *Reducing the Property Tax on Motor Vehicles in Georgia* (August 18, 1998) and hence is not considered here.

2. The Millner proposal states that a "homeowner will be entitled to a refund", but it does not state whether the refund is restricted to taxes paid on primary residence or if property taxes on vacation homes would qualify. In our analysis, we assume that only taxes paid on homesteaded property will be eligible.

3. To estimate the cost of the Millner proposal, we estimated the taxes that would be levied on residential property in each county by multiplying the millage rates in the county by the value of the net residential property tax base. Residential property includes more than just homesteaded property. From other data, we developed a range of estimates of the net value of homesteaded property as a percentage of net residential property and multiplied these by our estimate of the tax levied on residential property. We then took 20 percent of the resulting figure. An estimate was also developed by first estimating the total property taxes paid in Georgia in 1998 using 1995 property tax payments and projecting to 1998, and then multiplying that number by estimates of the homesteaded property as a percentage of total taxable property. Again, we then took 20 percent of that figure. The methods yielded very similar estimates of the cost of the Millner proposal.

4. To derive this estimate, we first assumed that all homeowners have a potential credit of $500. About 13.7 percent of Georgia income tax filers who itemize deductions have an income tax liability less than $500, and thus could not benefit from the full $500 credit. We then assumed that 13.7 percent of the aggregate potential credits is held by homeowners with a tax liability of less than $500. On average, these filers have a tax liability which would prevent 70.4 percent of $500 credit from being used. Thus, the maximum loss of usable credit is 9.6 percent (= .137 * .704). However, for most of these filers the potential credit is much smaller than $500; and thus, the actual effect is much less than 9.6 percent.

5. To develop the estimate of the Barnes proposal, we multiplied the millage rate in each county by the number of homesteaded properties in each county and then summed over all counties. That calculation assumes that the property tax reduction for every homeowner is the full effect of the $20,000 homestead exemption. We developed a range of estimates of the amount by which homeowners would not benefit because their net assessed value is less than $20,000.

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Date document archived: 2010-08-06

Date this page generated to accompany file download: 2014-04-15

IssueLab Permalink: http://www.issuelab.org/resource/analysis_of_the_barnes_and_millner_property_tax_relief_proposals

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Publisher(s): Fiscal Research Center of the Andrew Young School of Policy Studies

Author(s): David L. Sjoquist

Date Published: 1998-10-01

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Subject(s): General