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The Homestead Option Sales Tax: Lessons Learned from DeKalb and Rockdale Counties

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Introduction

Georgia counties levy local option sales taxes designed to generate revenue for county government expenditures through consumption taxes. These types of taxes redistribute the overall county tax burden by reducing the dependence on local property taxes but increasing the reliance on sales taxes. Several different variations of local option taxes exist in Georgia, including the Local Option Sales Tax (LOST), the Special Purpose Local Option Sales Tax (SPLOST), the Education SPLOST (ESPLOST), MARTA, the Municipal Option Sales Tax (MOST), the Transportation SPLOST (TSPLOST), and the Homestead Option Sales Tax (HOST).

Each functions as a 1 percent sales tax but is subject to differing restrictions in the use of the revenue. For instance, the LOST is a permanent tax, the revenues of which are deposited into the county's general fund. LOST revenues are used for the dual purposes of funding county government operations and reducing reliance on the property tax. The LOST agreement, governing the distribution of the funds between the county government and municipal governments in the county is renegotiated every 10 years. The SPLOST is typically a five-year tax, and its proceeds must be used for capital expenditures, such as roads and courthouses. ESPLOST and TSPLOST are variants of SPLOST designed to fund a particular expense such as school construction and repairs or transportation. The MOST is similar and allows an authorized municipality to raise revenues for a specific purpose such as sewer repairs.

In 1995, the Georgia General Assembly authorized counties to implement a HOST, which is used to reduce property taxes on owner-occupied housing and infrastructure. HOSTs have since been adopted by two Georgia counties — DeKalb and Rockdale.

Over the past several years, various recommendations and reports on economic development and government reforms have suggested that DeKalb County consider modifying, supplementing or replacing the HOST with a LOST or SPLOST, citing a lack of capital funding and harmful economic impacts associated with the HOST. At the same time, other metro-Atlanta counties including Cobb, Gwinnett and Cherokee have recently expressed interest in adopting a HOST. In 2012, and again in 2015, Cobb County commissioners considered organizing a referendum to vote on the tax.[1] The initiative was put before the voters in Cherokee County in a 2012 referendum but was not approved. Further attempts by Cherokee County commissioners to have a HOST initiative placed on the ballot in 2015 were not supported by the Georgia General Assembly.

This brief examines the features and economic impact of the HOST, as implemented in DeKalb and Rockdale counties. It describes the effects of municipal incorporation on HOST revenues and

[1] Sarrio, J., *Cobb leaders consider increasing sales tax to ease property tax*, Atlanta Journal-Constitution, November 9, 2012; Matthews, C., *County to back state Homestead Option Sales Tax plan*, The Cherokee Ledger-News, February 11, 2015.

capital outlays, the interactions with state and local taxes, the distributional issues of a HOST, and the lessons learned about this system of property tax relief based on the experience of DeKalb and Rockdale counties.

HOST Basics

The HOST legislation requires counties to hold a referendum to implement the 1 percent sales tax. It also requires that at least 80 percent of the previous year's HOST revenue[2] be used for property tax relief for homestead properties, which directly reduces the county tax liability of homestead property owners in municipalities and the unincorporated part of the county. Up to 20 percent of the revenue can be used to fund infrastructure improvements.

Properties eligible for county homestead exemptions are also eligible for HOST property tax relief. County homestead properties are the primary, non-commercial residences of homeowners, which includes single-family homes and condominiums. This means that commercial properties, such as rental apartments and business establishments do not qualify for property tax relief from HOST revenues.

The value of the HOST tax reduction varies by taxpayer with higher-valued homes or homes facing higher millage rates experiencing larger tax reductions. The reduction in taxes for each homestead property is equal to the net county tax liability of the property multiplied by the HOST credit rate.[3] The HOST credit rate equals the ratio of sales tax receipts from the prior year to the value of the county homestead property tax revenue, multiplied by one minus the capital factor.

HOST Credit Rate

$$= \frac{\text{Sales Tax Receipts from prior year} * (1 - \text{Capital Factor})}{\text{County Homestead Property Tax Revenue excluding debt service and exemptions}}$$

The HOST credit rate changes each year depending on the value of sales tax receipts from the prior year and on the capital factor chosen for the current year, but its value is the same for all taxpayers in the county. The HOST credit rate represents the percent of the current tax liability that is covered by the HOST receipts, so that a 60 percent HOST credit rate reduces current county tax liabilities by 60 percent. The HOST capital factor is set by the county commissioners annually and represents the percent of total HOST receipts that will be set aside for capital improvements. By law, the capital factor varies from zero to 20 percent.

[2] That is, the annual HOST credit rate for a given year is computed based on the value of HOST receipts from the prior year.

[3] The net tax liability equals the county millage rate times the assessed value of the property less the value of the homestead and other exemptions.

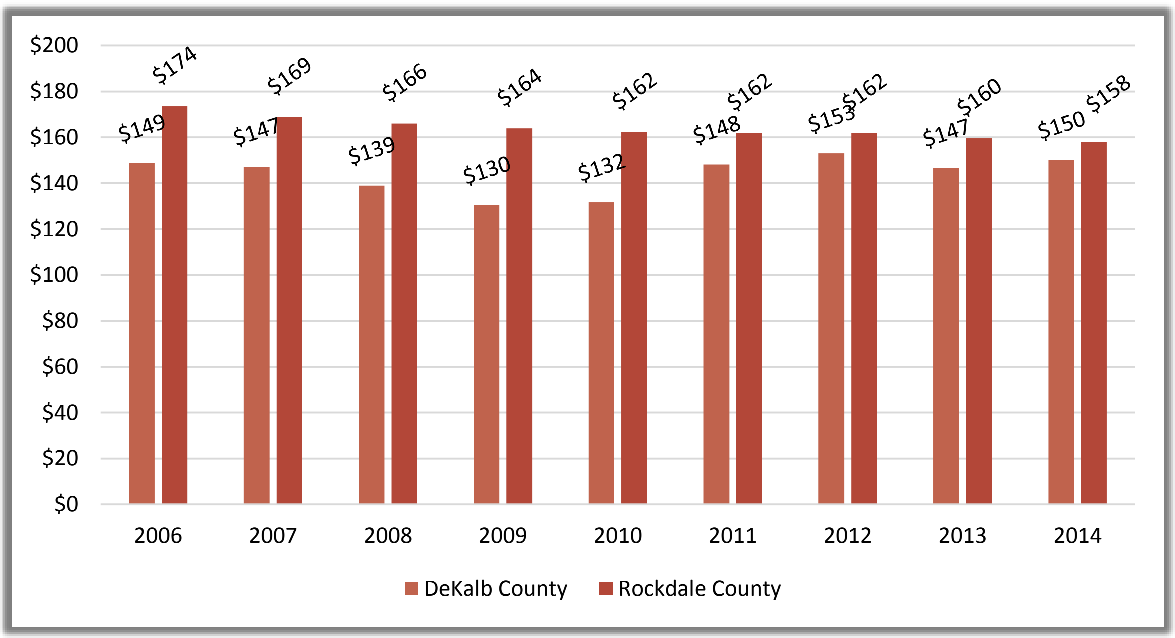
The HOST revenues cannot be used to reduce school, state or municipal property tax liabilities. Furthermore, HOST revenues cannot be applied against county property taxes levied for purposes of bond repayments. Once adopted by a county, the HOST remains in place until the voters of that county vote to discontinue the tax.

HOST Revenues and Property Tax Relief

In a referendum on March 18, 1997, DeKalb County voters adopted the HOST, which was implemented on July 1 of that same year. The implementation of the HOST was intended to address two major issues: a lack of adequate capital funding and the worry of a loss of middle-class residents due to high property taxes. In July 2001, Rockdale County implemented a HOST after being approved by 70 percent of voters in a March 2001 referendum.

Figure 1 shows HOST revenues for DeKalb and Rockdale counties from 2006 through 2014 on a per capita basis. Prior to 2011, the base of the HOST was equal to the base of the LOST with the exception of food for home consumption. As of January 1, 2011, after passage of HB 1221, which applied the tax to the sale of food and "food ingredients," groceries were no longer exempted from HOST.[4]

Figure 1: DeKalb and Rockdale County Per Capita HOST Receipts

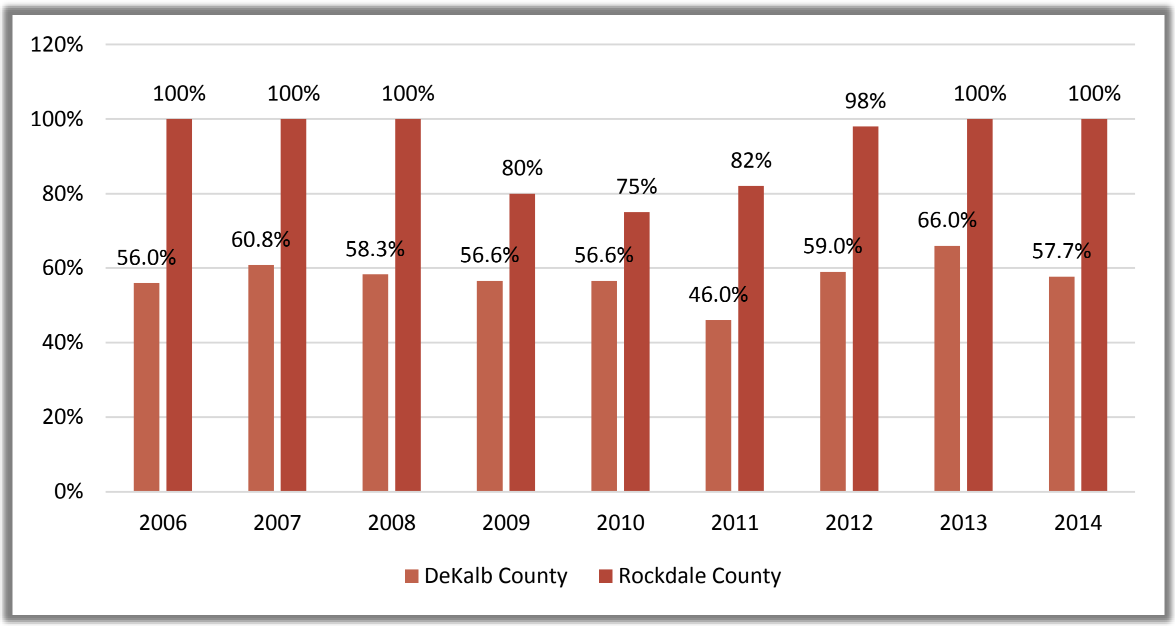


Sources: Georgia Department of Revenue and U.S Census Bureau

[4] Swint, M., *New law adds a grocery tax in DeKalb*, Dunwoody Crier, September 22, 2010.

In 2006-2008 and in 2013-2014, HOST revenues were sufficient to provide a complete exemption of homestead property owners from county property taxes in Rockdale County. Homeowners did, however, remain liable for any applicable school, bond, state, and municipal property taxes. In other years, the HOST credit rate in Rockdale County has ranged from 75 percent to 98 percent, as shown in Figure 2. The HOST credit rate in DeKalb County averaged 57.4 percent between 2006 and 2014. In 2013, the HOST provided a 66 percent exemption; in 2014, this was reduced to 57.7 percent, meaning homeowners were liable for 42.3 percent of their original county property tax bills.[5]

Figure 2: DeKalb and Rockdale County HOST Credit Rate



Sources: DeKalb County Office of Finance and Rockdale County Department of Finance

The HOST credit has reduced the county effective property tax millage rate[6] for homestead property. In 2014, the effective millage rate for homeowners in DeKalb County was 9.94 mills,[7] just below Cobb County's 10.38 mills, and well below Gwinnett County's 13.75 mills and Clayton County's 14.869 mills (Table 1). Due to the HOST, the effective tax rate for homestead property in Rockdale County was zero. However, because the counties cannot use HOST funds to offset the non-homestead millage rates, DeKalb and Rockdale counties' businesses and other non-homestead property owners faced a significantly higher millage rate, 21.21 mills and 20.24 mills, respectively.

[5] Gottlieb, J., *Homestead Option Sales Tax for DeKalb County – Options for Reform*, August 2014.

[6] The effective tax rate is the tax rate that exists after the value of the HOST credit is taken into account. The effective tax rate equals the tax liability divided by net assessed value.

[7] The tax rate includes the property tax rate for Grady Hospital, bond payment and county operations.

Table 1. Effective County Millage Rates (2014)

COUNTY	MILLAGE RATE
DeKalb (Non-Homestead)	21.21
Rockdale (Non-Homestead)	20.24
Henry	16.30
Clayton	14.87
Gwinnett	13.75
Fulton	12.05
Cobb	10.38
DeKalb (Homestead)	9.94
Rockdale (Homestead)	0.00

Source: Georgia Department of Revenue

The Effect of Municipal Incorporation

Rockdale County does not share HOST receipts with the city of Conyers, currently the only municipality in the county. Unlike Rockdale County, DeKalb County must share a portion of the HOST revenue with its municipalities. When the HOST was initially authorized in 1997, DeKalb County and the municipalities that existed at that time negotiated an Intergovernmental Agreement (IGA) governing the use of the designated capital funds from the HOST. This IGA included a formula to determine the distribution of the funds, as well as compliance terms for the municipalities, such as documentation of expenditures for capital projects.

In June 1999, the county distributed HOST payments to the cities of Atlanta, Chamblee and Decatur. Several other DeKalb County cities filed a lawsuit against the county claiming it did not distribute the funds according to the agreed upon formula. The lawsuit with the existing municipalities continued unresolved until 2010. In a separate action in 2007, the Georgia General Assembly amended the law specifying the use of the HOST funds to provide for direct payments to all qualified municipalities in the county, including newly incorporated areas and any existing municipality for which the IGA was ruled null and void. In 2009, Dunwoody received HOST funds as a newly created municipality. In 2010, as part of the settlement of the original lawsuit against the county, the Supreme Court of Georgia ruled that the IGA between the county and the original municipalities was unconstitutional. This ruling, in combination with the legislation passed by the Georgia General Assembly in 2007, cleared the way for all existing municipalities to receive a distribution of HOST proceeds.[8] In addition, as new areas of the county become incorporated, they are also eligible to receive a distribution of the HOST revenues.

[8] The county terminated the IGA with Atlanta in 2001, after the city failed to provide adequate documentation of expenditures for capital projects as required by the IGA. The Georgia Department of Revenue ruled that termination is not the same as null and void, and therefore Atlanta is not entitled to receive a share of HOST revenue.

Based on the experience of DeKalb County, as new cities are created, the amount of funds available for distribution to all existing cities diminishes. That is, the creation of new municipalities has resulted in the county government having less funds for capital improvements and has also resulted in existing municipalities receiving a reduced share of the HOST proceeds.

The HOST Distribution Structure

By law, a minimum of 80 percent of HOST revenue collected in the prior year must be used to reduce county property taxes on homesteaded property. This includes county taxes on homes located in the unincorporated area and in municipalities. The remaining funds, hereafter referred to as the HOST capital funds, are between zero and 20 percent of the total collected and must be used for capital improvements. Historically, DeKalb County has used between 80 and 100 percent for homestead property tax relief. Rockdale County has used 100 percent for property tax relief since 2007.[9]

The HOST capital funds are shared between the county government and all qualifying municipal governments in the county through two consecutive distributions: equalization payments and excess payments. The amount of revenues received by the municipal governments depends on a number of factors, such as the overall number of qualified municipal governments in the county, the overall amount of HOST revenue to be shared, the annual capital factor, the combined county millage rate and the county millage rates levied in the incorporated areas.[10]

The equalization payments occur because the cities typically have lower county millage rates than the unincorporated areas, resulting in lower county property tax liabilities for municipal residents. Because the HOST formula covers a fixed percentage of the county property tax liability regardless of location, municipal residents with lower property tax liabilities receive a smaller HOST credit amount compared to residents in the unincorporated area, even though the credit amount represents the same percentage of their county property tax liability.

As a form of indirect compensation to the municipal residents for this disparity, the equalization payment distributes part of the HOST capital funds to the municipal governments in the county. This payment amount increases as the difference between the county unincorporated and municipal millage rates grows and is paid directly to the municipal governments. There are no restrictions on the use of these funds by the municipal governments, though some municipal governments may use them for capital projects.

After the equalization payments to the municipalities have been made, an excess payment distributes the remaining amount of the HOST capital funds to the county and the municipal

[9] Queen, A., *Rockdale commissioner says it might be time to revisit HOST*, Rockdale Citizen, August 12, 2013.

[10] See O.C.G.A §48-8-104

governments in direct proportion to the value of the property tax base as it is distributed between the unincorporated part of the county and the municipalities. Municipalities that account for a larger share of the county's property tax base receive a larger excess payment.

As an example, in 2014, the relevant HOST distributions in DeKalb County were:

	VALUE	CALCULATION
Total HOST receipts to be distributed to taxpayers and local governments	$104.6 million	
HOST funds distributed in the form of property tax relief to owners of homestead property for property taxes paid to the county	$83.7 million	80% of $104.6
Remaining HOST funds for distribution (i.e. HOST capital funds)	$20.9 million	20% of $104.6
Value of equalization payments to municipal governments	$18.3 million	87.6% of $20.9 million
Value of excess payments to municipal governments	$1.1 million	5.3% of $20.9 million
Amount available to the county for capital improvements from the HOST capital receipts	$1.5 million	7.2% of $20.9 million
Total received by homestead property owners	$83.7 million	80% of $104.6
Total received by DeKalb County municipal governments	$19.4 million	18.5% of $104.6
Total received by DeKalb County government	$1.5 million	1.4% of $104.6

Distributional Effects of HOST

LOW-INCOME VERSUS HIGH-INCOME

Because the HOST affects both the property and sales tax, it imposes a distributional effect that depends on the combined distributional nature of both taxes. Sales taxes are generally considered regressive, as they form a larger share of expenditures for lower-income households. Higher-earning households that are able to save tend to consume a larger number of items that are not subject to sales taxes, and therefore are less affected by this tax. HOST's 1 percent additional sales tax, thus, has a relatively larger effect on the budgets of a county's lower-income residents compared to its wealthier inhabitants.

At the same time, property taxes are can be considered a more progressive form of taxation because homeownership rates rise with income. Thus, with its shift away from property taxation and toward a higher reliance on consumption taxes, generally considered more regressive, the HOST shifts a larger part of the tax burden onto lower income individuals.

HOMESTEAD PROPERTY VERSUS NON-HOMESTEAD PROPERTY

Because the HOST applies only to homestead[11] property taxes and does not provide a benefit for non-homestead properties, the HOST favors homeowners over renters. Firstly, renters receive no property tax bill, and therefore do not benefit directly from the HOST credit. Secondly, rental apartments are considered non-homestead properties, so the owners do not qualify for a millage rate reduction. This means that apartment complexes or other rental properties face a higher effective millage rate than do residential properties, increasing the cost of housing for non-homeowners. At the same time, the HOST receipts generated by the population of renters in the county, who on average, have lower incomes than homeowner, are used to fund the property tax relief for homestead properties.

In the same manner, the HOST imposes a higher effective rate on commercial property owners, such as businesses. This places businesses at a competitive disadvantage with businesses in other counties, which can lead to reduced economic development within the county.

The Interaction of State and Federal Taxes with Property Tax Relief Programs

The HOST, like all forms of local property tax relief programs, interacts with the federal and state income tax systems. Although the majority of taxpayers do not itemize expenses on their tax returns, most homeowners do and can use their property tax bill to reduce their federal and state income tax liability. Because the HOST reduces property taxes for homestead properties, the value of the federal and state income tax deduction decreases as well. That is, by providing the HOST credit to reduce property taxes, a county reduces the amount of itemized expenditures taxpayers can claim against their federal income liability.

To illustrate the magnitude of this effect, assume an itemizing homeowner with a $200,000 house in unincorporated DeKalb County. While this example uses information from DeKalb County, the results are applicable to any county that adopts the HOST or other forms of property tax relief. Assume further that this homeowner’s income is high enough so that she faces the 25 percent marginal federal income tax bracket[12] in addition to the 6 percent state income tax rate.

Without the HOST credit, the homeowner incurs a property tax liability of $1,502. By itemizing, the homeowner reduces her income taxes by $465 in the absence of the HOST credit. However, the homeowner in 2015 is eligible for a HOST credit of 58 percent, or $871.[13] By itemizing the property tax liability after the HOST credit is accounted for, the owner reduces her income tax by

[11] Homestead property includes single family primary residences and condominiums but excludes all commercial property, second homes and multifamily property.

[12] The 25 percent marginal income bracket corresponds to income between $74,900 and $151,200 in 2015.

[13] Gottlieb, J., *Homestead Option Sales Tax for DeKalb County – Options for Reform*, August 2014.

$196. Notice though, that $270 of the HOST credit is offset by the increase in state and federal income tax liability that results from a reduced property tax liability. In our example of a $200,000 home, this offset is equal to 31 percent of the original HOST credit of $871.

Table 2. Example of HOST and Federal and State Deduction Interaction

	VALUE	CALCULATION
Value of property tax liability before HOST credit and income tax deduction	$1,502	
Value of HOST credit	$871	58%*$1,502
Value of the federal and state deduction for property taxes, based on pre-HOST tax liability	$465	6%*$1,502 + 25%*$1,502
Value of the federal and state deduction for property taxes, based on after-HOST tax liability	$196	6%*($1,502-$871) + 25%*($1,502-$871)
Reduction in property tax deduction due to HOST	$270	$465-$196
Reduction as a % of original HOST credit	31%	$270/$871

Lessons Learned about HOST

HOST AS A METHOD OF PROPERTY TAX RELIEF

In DeKalb and Rockdale counties, the HOST has proved a fairly sufficient and reliable revenue source for property tax relief. In 2006, the DeKalb County HOST credit covered about 56 percent of the homestead property tax liability, and 58 percent in 2014.[14] In Rockdale County, the HOST has covered 100 percent of the county property tax liability for homestead properties for several years.

As with any tax subsidy, the purpose is to encourage more of the subsidized activity at the expense of the unsubsidized activity. This may result in a shift toward the purchase of more residential property in the county. However, the addition of more residential property results in a reduced amount of property tax relief provided per homestead property because the HOST receipts have to be shared among a larger number of homeowners. Furthermore, the HOST favors owners of homestead property over owners of non-homestead property and renters and reduces the progressivity of the existing local government tax system. This creates a millage rate differential between homeowners and commercial properties in a county. In 2014, DeKalb County businesses faced property tax rates that were 11.27 mills higher than homestead property owners. In Rockdale County, this differential was 20.24 mills. Commercial properties in both counties face much higher rates than competitors in neighboring counties that face the same property tax rates as homestead properties.

[14] DeKalb Annual Budget for 2006, p. 22.

Additionally, HOST property tax relief may have the unintended consequence of leading to higher overall county property tax rates. The amount of public services citizens demand depends on the "price" they face for these services. A county that wants to provide additional services will have to increase property taxes to fund these. The HOST significantly reduces the increase in property taxes that homeowners face. In effect, the burden of funding the additional services falls primarily on non-homesteaded property, i.e., renters and commercial property owners. Thus, one could expect less resistance to a property tax increase on the part of voters who are homeowners.

As an alternative to offering property tax relief through the HOST, Cobb, Gwinnett, and Fulton counties offer property tax relief through the property tax system itself by means of various property tax exemptions. Alternative forms of property tax relief are widespread, and many are currently in use by counties in Georgia, including DeKalb County. These include assessment freezes, circuit breakers[15] and various types of exemptions. These forms of property tax relief can be targeted to various demographic groups, so as to limit their cost to the county, and they may be applied to both homestead and non-homestead property depending on how the relief is structured. However, none of these forms address the disparity between property owners and property renters.

HOST AS A METHOD OF CAPITAL FUNDING

The structure of the HOST, as levied in DeKalb County, makes it less successful in achieving its original goal of providing capital funding. As currently structured, the funds available for capital improvements are those that remain after the equalization and excess payments have been made to the qualifying municipal governments in the county. This is not an issue in Rockdale County, because the HOST receipts are not shared with the city of Conyers.

There is no requirement that the funds received by the municipal governments be used for capital improvements in their jurisdictions. While requiring the municipal governments to use these funds for capital improvements would not relieve the county of its capital funding obligations, it would help support the overall level of capital improvements in the county. Additionally, the increased incorporation of the county has resulted in a significant increase in the amount of equalization and excess payments made to the municipal governments, further reducing the amount of funds available for countywide capital improvements.

As a solution to the lack of funds dedicated to capital improvements in DeKalb County, the Georgia General Assembly passed the Equalized Homestead Option Sales Tax Act for 2015, which allows for a referendum on a SPLOST in DeKalb County. If approved by a majority of voters,

[15] Circuit breakers tie property taxation to household income and are usually designed to protect lower-income or elderly individuals and households from being unable to shoulder the burden of their property tax. Under such a program, property tax credits are awarded when a household's property tax bill exceeds a certain percentage of its income.

DeKalb County will impose an additional sales tax to raise revenue for capital expenditures countywide. In addition, 100 percent of the HOST revenues will be applied to residential property tax relief each year, and the HOST will no longer be used as a means to provide funding for capital improvements. If approved, this will provide approximately $100 million per year for capital improvements in the county through the SPLOST, as well as dedicate $100 million of HOST funds for property tax relief.

Conclusion

Answering the question of whether the HOST is an effective and appropriate choice of tax relief for a county depends in part on the mix of county taxes that are currently levied. Counties in Georgia are limited in the number of local option taxes that may be levied. Under current law, most counties may levy no more than three local option sales taxes at any one time.[16] Both DeKalb and Fulton counties are required to levy a one-cent tax for the support of MARTA, and almost all counties in the state have opted to levy an ESPLOST to support education. Therefore, DeKalb County can only levy one additional local option sales tax, which is the HOST, the proceeds of which are largely designated for property tax relief. In contrast, in addition to the MARTA and the ESPLOST Fulton County levies a LOST, the proceeds of which are designated for county expenditures. While Rockdale County levies a HOST, it also levies a SPLOST, which provides an additional source of revenue for capital expenditures. Cobb and Gwinnett counties are not required to levy a tax to support MARTA and as a result levy only two local option sales taxes, an ESPLOST and a SPLOST.

Table 3. Local Option Sales Taxes

COUNTY	LOCAL OPTION SALES TAXES LEVIED, 2014
Cobb	SPLOST, ESPLOST
DeKalb	MARTA, HOST, ESPLOST
Fulton	MARTA, LOST, ESPLOST
Gwinnett	SPLOST, ESPLOST
Rockdale	HOST, SPLOST, ESPLOST

Thus, the conclusion that can be drawn from this research is that the HOST creates some inequities in the property tax base between homestead and non-homestead property. On the other hand, all forms of property tax relief create inequities among groups to some degree. However, the distortions associated with the HOST are likely to be more significant than those associated with other property tax exemptions because the HOST is a less targeted, more generous form of property tax relief. Although the HOST is successful at providing substantial

[16] Counties located in the regions of the state that adopted a TSPLOST may levy a fourth penny designed for certain transportation expenditures.

property tax relief to homeowners, it creates a significant differential between commercial and homestead property tax rates, allows for less flexibility in the use of funds than a LOST, and may increase overall property tax levels by reducing resistance to property tax increases among homeowners.

The capacity of the HOST to provide adequate capital funding is limited due to the legal constraints of using at least 80 percent of the proceeds for property tax relief and the requirement to share part of the proceeds with qualifying municipalities in the county. This is particularly problematic in DeKalb County, which has an increasing number of incorporated areas and no other dedicated source of capital funding; it is less of an issue for Rockdale County, which levies a SPLOST in addition to the HOST. The HOST does not appear to be a sufficient source of capital funding on its own and should not be levied as a replacement or substitute for a LOST or a SPLOST.

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