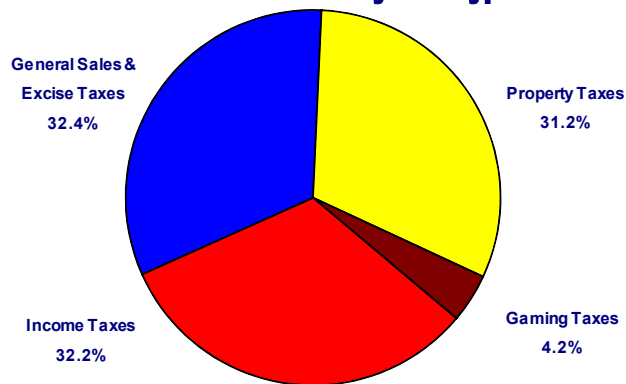


# Encourage Adoption of Local Option Income Taxes To Replace Property Taxes

Nearly everyone agrees that, in the 21<sup>st</sup> Century, the long standing practice of relying upon the three major taxes – sales, income, property – in roughly equal parts no longer works in Indiana. In 2005, Indiana’s tax revenue from state and locally imposed taxes produced about 32% from sales, 32% from income, and 31% from property taxes. The remaining 4% of tax revenue came from gaming taxes and other miscellaneous sources.<sup>1</sup>

When examining state and local government expenditures, it is difficult – and misleading – to separate state taxes from local. The state provides over \$2.0 billion of revenue obtained from sales and income taxes to replace property taxes. In addition, the state provides \$4.0 billion of support for public schools – or 85% of total operating expenditures. As recently as 30 years ago, the state provided but one third of public school operating funds, with the remaining two thirds coming from the property tax. Combining funding from both state and local taxes, local spending now totals well over \$12.0 billion annually, less than one half of which is funded by the property tax.

**State and Local Taxes 2005  
Share of Total - by Tax Type**



Nevertheless, of those taxes which the state has given local governments the authority to impose, the property tax is currently the major source of revenue. Seventy-seven percent of tax revenue comes from the property tax.

<b>Share of <u>Local</u> Tax Revenue By Tax Type</b>		
<b>Local</b>	<b>Revenue</b>	<b>Percent of Total</b>
Income Taxes (Individuals & Businesses)	\$ 1,114.9	14.4%
Excise Taxes	\$ 477.8	6.2%
Property Taxes (includes vehicle excises)	\$ 5,979.1	77.1%
Gaming Taxes	\$ 184.9	2.4%
<b>Total</b>	<b>7,756.7</b>	<b>100.0%</b>

Statewide, the property tax raises nearly \$6.0 billion. In 2002 (the last year for which national comparison data are available) Hoosiers paid property taxes of \$821.80 per capita. Indiana ranks 27<sup>th</sup> of the 50 states in that statistic.

The movement in Indiana away from property taxes and toward income taxes began more than 30 years ago. Local option income taxes were originally enacted in 1973 as part of the “Bowen Property Tax Reforms.” The first, the County Adjusted Gross Income Tax (CAGIT) was intended to replace property taxes and reduce the reliance on property taxes by local

governments. In 1987 and 1989, two additional local option income taxes – the County Option Income Tax (COIT) and the County Economic Development Income Tax (CEDIT) – were enacted. Combined, the three local option income taxes now account for over \$1.1 billion of tax revenue for local governments.

HEA 1478 allows counties to enact a local option income tax for the specific purpose of reducing property taxes. It also provides for other local option income taxes that will either a) provide funding for increases in spending that would otherwise have been funded by property taxes or b) provide funding for additional public safety expenditures.

These options, if enacted by local governments, can reduce by significant amounts the net property tax paid by taxpayers across the state. For example, if the local option to reduce property taxes is enacted at the 1.0% rate by every county, net property taxes could be reduced by 21% statewide. If the replacement were focused on homesteads, homeowner property taxes could be reduced by 67%.<sup>ii</sup>

The legislation, and subsequent extensions of deadlines by which time counties must act, give counties the ability to reduce property taxes almost immediately – with the first impact occurring on property tax bills for 2008.

While these measures may not be the best alternative in every case, local governments should be encouraged to explore them as ways to reduce the property tax burden.

<sup>i</sup> Indiana Fiscal Policy Institute, Information Brief #1, January, 2007

<sup>ii</sup> Indiana Legislative Services Agency