How We Got Here from There: A Chronology of Indiana Property Tax Laws

Dagney Faulk, Ph.D.

Senior Fiscal Analyst, Indiana Legislative Services Agency and Assistant Professor of Economics, Indiana University Southeast

With the recent general reassessment of real property, the various resulting court cases, and the localized billing problems that have followed the reassessment, property taxes have come to the forefront of the public policy debate in Indiana. This is an opportune time to review the major legislation[1] that has affected Indiana property taxes over the past few decades, providing a history lesson and perhaps some perspective on how the system became what it is today.[2] The tables and charts provide supplemental information, helping to put local government taxes and expenditures in perspective.

In Indiana, real property (land and improvements that are considered permanent fixtures, such as a house) and certain types of personal property (tangible property not permanently affixed to real estate, such as equipment and machinery) are subject to the property tax. The bulk of property tax revenue (approximately 70 percent in 2002) is raised through the tax on real property. Only real property is subject to periodic general reassessments to determine taxable value. In contrast, the value of personal property is self-reported by taxpayers each year. Businesses pay the bulk (approximately 99 percent in 2002) of the personal property tax. Property owned by government and nonprofit organizations is not subject to the property tax.

Table 1
Local Government Revenue in Indiana, 2000

Type of Revenue	Value (000's)	Distribution	Per Capita
General	$16,679,045	100.0%	$2,743
Intergovernment	$6,003,533	36.0%	$987
Own-Source	$10,675,512	64.0%	$1,756
Total Tax	$6,259,077	37.5%	$1,029
Property Tax	$5,547,847	33.3%	$912
General Sales Tax	$0	0.0%	$0
Individual Income Tax*	$515,100	3.1%	$85
Corporate Net Income Tax	$0	0.0%	$0
Other Taxes	$196,130	1.2%	$32
Total Charges	$3,008,473	18.0%	$495
Own-Source General	$1,407,962	8.4%	$232

*Indiana local income taxes are CEDIT, CAGIT, and COIT.
Source: Rockefeller Institute of Government; U.S. Census Bureau

Table 2
Glossary of Terms and Acronyms

AVGQ	Assessed Value Growth Quotient
CEDIT	County Economic Development Income Tax
CAGIT	County Adjusted Gross Income Tax
COIT	County Option Income Tax
PTRC	Property Tax Replacement Credit
DLGF	Department of Local Government Finance
LSA	Indiana Legislative Services Agency
Real Property	Land and improvements considered permanent fixtures
Personal Property	Tangible property not permanently affixed to and part of real estate
HEA	House Enrolled Act
SEA	Senate Enrolled Act
P.L.	Public Law

Bowen Tax Package (1973)

Property tax reform in Indiana can be traced back to this tax reform package, passed in response to increasing local property tax rates and levies.[3] The reform limited local governments' ability to increase property tax levies, set up alternate funding mechanisms for local government, and shifted some of the responsibility for revenue generation to the state. School funding was treated separately and increased through a state school aid formula. The reform package

1. doubled the sales tax from 2 percent to 4 percent (exempting groceries) and allocated the extra revenue to property tax reduction through the Property Tax Replacement Credit (PTRC);[4]
2. permitted counties to levy local option income taxes (CAGIT) with most of the revenue used to reduce property taxes;
3. set limits on property tax rates and levies for counties adopting CAGIT;
4. established tax control boards.

General Assembly Changes (1979)

These changes, effective in 1980, were a response to reassessment and the economic environment (high inflation) of the late 1970s.

1. For local taxing units, the growth in tax levies was limited to the same growth rate as the Assessed Value Growth

Quotient (AVGQ). AVGQ equals the average growth in AV over the prior three years, excluding reassessment, which was scheduled to occur every four years. The minimum AVGQ was set at 5 percent and the maximum was 10 percent. School property tax levies were restricted using the school funding formula. Over the years, many jurisdictions would "bank" the difference between their actual and maximum levy growth to use in future years if needed.
2. Taxing units were allowed to appeal to the state tax board for an excess levy—above the AVGQ normally permitted.

Table 3
Local Government Expenditures in Indiana, 2000

Expenditures	Value (000's)	Distribution	Per Capita
General	$16,348,826	100.0%	$2,689
Intergovernment	$61,120	0.4%	$10
Direct	$16,287,706	99.6%	$2,679
Elementary and Secondary Education	$7,351,414	45.0%	$1,209
Public Welfare	$458,657	2.8%	$75
Higher Education	$529	0.0%	$0
Health and Hospitals	$1,948,501	11.9%	$320
Corrections	$190,187	1.2%	$31
Police	$644,419	3.9%	$106
Highways	$711,305	4.4%	$117
Interest	$595,689	3.6%	$98
Other	$4,387,005	26.8%	$721

Source: Rockefeller Institute of Government; U.S. Census Bureau

Court-Ordered Reassessment (1993-2000)

The initial lawsuit, *Town of St. John* v. *State Board of Tax Commissioners*, was filed in 1993. The plaintiffs argued that the method of calculating "true tax value" in Indiana could lead to different tax values for property with the same market value, thus violating the Indiana Constitution which requires a "uniform and equal rate of property assessment and taxation." According to the Indiana Constitution, it is the responsibility of the General Assembly to provide a "uniform and equal rate of assessment and taxation."

In total, six opinions were issued by the Indiana Supreme Court and the Indiana Tax Court between 1996 and 1998 to clarify how "true tax value" should be determined. In 1998, the Indiana Supreme Court ruled that property should be assessed "under a system that incorporates an objective reality" to determine the true tax value of a property. "Objective reality" does not have to be the same as market value. Subsequently, the tax court required the State Board of Tax Commissioners to implement a new assessment system, specifying that the new regulations be in effect by June 1, 2001, and the general reassessment of real property occur by March 1, 2002. (The last reassessment took place in 1995 for taxes due in 1996.)

The old assessment method calculated a true tax value of property based upon its "reproduction cost." That is, the cost to reconstruct a duplicate of the property using the same materials, design, and workmanship that were used in the original property. This value was determined through tables disseminated by the State Board of Tax Commissioners that were based upon 75 percent of the 1991 construction values.

The current assessment, however, is based upon values that are 100 percent of 1999 construction data taken from the Marshall & Swift Assessment Manual. The Marshall & Swift 1999 data are based upon the "replacement cost" of the property rather than the "reproduction cost." Replacement cost is the current cost of constructing a structure of equal utility to the subject property using modern materials, design, and workmanship.

During reassessment, all real property is revalued for tax purposes. Due to inflation, most property increases in value. An increase in tax value does not mean necessarily that the property owner's tax bill will increase since a lower tax rate could be used to raise the same amount of revenue as before reassessment. Currently, the Indiana Fiscal Policy Institute is coordinating a property tax equalization study to objectively measure the accuracy of assessments in each of Indiana's ninety-two counties.

HEA 1001 (P.L. 192, 2002 Special Session)

This statute included tax reforms for gaming, property taxes, business income taxes, and other taxes and provisions. The statute changed the AVGQ formula to allow property tax levies to increase at the rate that Indiana nonfarm personal income increases. The statute increased the standard homestead deduction from $6,000 to $35,000 and the homestead credit to 20 percent,[5] required counties to deduct 100 percent of the assessed value of inventory from the property tax base by 2006, and allowed counties to impose an additional County Economic Development Income Tax (CEDIT) to provide revenue for increased homestead credits to offset the inventory tax deduction.[6] This statute also raised the sales tax from 5 percent to 6 percent to offset the increased expenditures for property tax relief.

HEA 1714 (P.L. 245, 2003)

This statute established a four-year cycle for the general reassessment of all real property in Indiana. Under this system, the next general reassessment (requiring the inspection of all real property) should begin July 1, 2007, and occur every four years after that. The reassessment should be completed by March 1 of the next odd-numbered year (2009) and used as the basis of property taxation in the next year (2010). Then another general assessment would follow in 2011. The statute also specified that the Department of Local Government Finance (DLGF)[7] should establish a system of annual adjustments to account for changes in property value in years between general assessments. These adjustments should be first applied in 2005.

SEA 1 (P.L. 1, 2004)

This statute contains a variety of provisions to address some of the impacts of the court-ordered reassessment, which became apparent in 2003 as the 2002 property tax reassessments and levies were mailed to property owners.

The statute authorizes the Department of Local Government Finance to take over the 2003 general reassessment process in a county if it determines that the county's reassessment is likely to be inaccurate.[8] It reduces the revenue raising capacity of local governments by setting maximum rates and eliminating the banking of unused levy allowances in calculating the maximum permissible property tax levy for a civil taxing unit, for a county family and children property tax levy, and for a county children's psychiatric treatment services property tax levy. The statute allows counties to petition the DLGF to authorize property tax payments to be made in installments, waive late payment penalties for taxes payable in 2004, and allow automatic refunds for successful appeals for any taxpayer.

Summary

Since the 1970s, legislative actions have expanded the options that local governments have for funding local services, primarily through local option income taxes, and increased the level of property tax deductions and credits. Currently, 50 percent of state sales tax revenue, 14 percent of state individual income tax revenue, and a portion of corporate adjusted gross income tax revenue are distributed to the Property Tax Replacement Fund, which is used to reduce local property tax burdens via the Property Tax Replacement Credit.

The property tax has long been the most unpopular of the three major revenue sources available to state and local governments. This unpopularity is primarily attributed to the large annual or biannual payments that make this tax more visible to taxpayers, whereas sales and income taxes are paid in smaller amounts over the course of a year. Large changes in assessed value further add to the unpopularity of the tax. A regular system of general reassessment, annual adjustments, and equalization studies to determine if reassessment is equitable among jurisdictions can lend credibility to the property tax system and a level of certainty for taxpayers concerned with year-to-year changes in tax liability. Property taxes are a stable source of revenue for local governments since they do not fluctuate with the business cycles as sales and income tax revenues do, and perhaps more to the point, property taxes are the major source of revenue currently available to Indiana's local governments. ◄

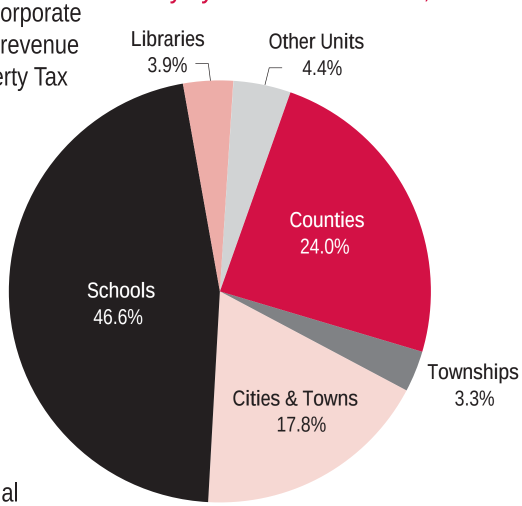
Sources

- Bennett, David J. *Uniform and Equal: Why the Courts Overturned Indiana's Property Tax System—And What Happens Next*. Fort Wayne, IN: Freeman and Costello Press, 2001.
- Bennett, David J. *Financing Local Government in Indiana*. Fort Wayne, IN: Lincoln Printing Corporation, 1992.
- Indiana Legislative Services Agency. *Indiana Handbook of Taxes, Revenues, and Appropriations.* Various years.
- "Indiana Property Tax Reassessment." Kahn, Dees, Donovan and Kahn, LLP, April 2003 Newsletter. Online at www.k2d2.com/newsarchives/year2003/apr03.html.
- State Board of Tax Commissioners. *2002 Real Property Assessment Manual*. Final Rule, LSA Doc. 00-108(F), May 23, 2001.

Endnotes

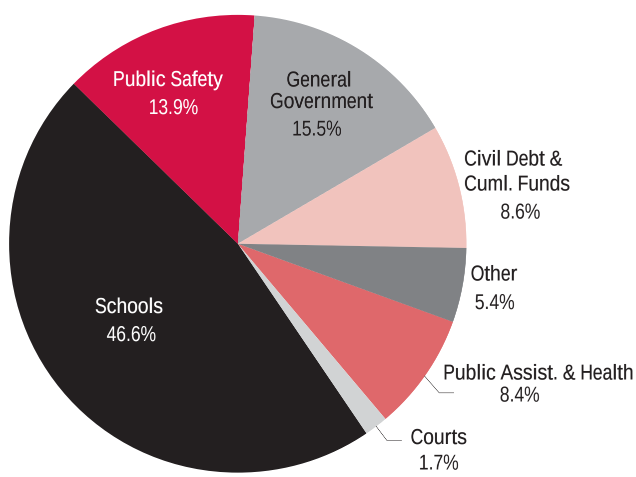
1. Legislation that has made major changes in the structure of the property tax is included. This article makes no attempt to chronicle every piece of property tax legislation that the General Assembly has enacted.
2. The Indiana Code, the various enrolled acts referred to in this document, and the fiscal impact statements for each enrolled act are available through the Indiana General Assembly's website at www.in.gov/legislative/.
3. The property tax levy is the amount of income that a unit of government raises from the property tax.
4. Each taxing unit receives 20 percent of its operating tax levy through the Property Tax Replacement Credit (PTRC). Only levies attributable to real property and nonbusiness personal property are included when calculating the credit. The 20 percent does not apply to debt incurred after 1984, school capital projects, building funds, or excess levies.
5. The homestead credit was 10 percent from 1998 to 2003.
6. The County Option Income Tax (COIT) may also be used to replace property tax revenue in taxing units and school corporations that increase the homestead credit. COIT was established in 1984.
7. The Department of Local Government Finance assumed most of the functions of the State Board of Tax Commissioners beginning January 2002.
8. HEA 1902 (P.L. 151, 2001) authorized the State Board of Tax Commissioners to contract with an accounting firm to reassess real property in Lake County. SEA 1 extended this authority to other counties if needed.

Figure 1
Distribution of Net Property Tax Levy by Unit of Government, 2003*



*The 2003 net property tax levy totalled approximately $4.9 billion.
Source: Indiana Legislative Services Agency

Figure 2
Distribution of Net Property Tax Levy by Use of Funds, 2003



Source: Indiana Legislative Services Agency