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Examining the Effects of Increased Homestead Exemptions

By Maurice Scholten

Maurice Scholten, Legislative Director of the Taxpayers' Federation of Illinois. Before joining TFI, Mr. Scholten was Senior Legal Counsel for the Senate President's Office where he worked on taxes, pensions, workers' compensation and unemployment insurance. He received a Bachelor of Science in Mechanical Engineering from Iowa State University and a Juris Doctor from the Loyola University Chicago School of Law.

There is no such thing as a popular tax, but property taxes are easily one of the most unpopular taxes, if not the most unpopular. By any measure, here in Illinois, property taxes are high.[1] A high, unpopular tax is therefore something that politicians want to say they are fighting to fix. Since property taxes are levied by local governments and not the State, state legislators are somewhat restricted as to how they can lower property taxes. Often they propose to create or expand homestead exemptions to attempt to placate taxpayers.[2] The property owner sees a higher exemption that lowers their equalized assessed value ("EAV"), and believes it must result in a lower property tax bill. However, property taxes are a complex system with many moving parts. Newton's third law of motion seems to apply to our property tax system: for every action, there is an equal and opposite reaction. Any tax reduction received by a homeowner receiving an exemption, will result in someone else paying more in property taxes to make up the difference. Expanded exemptions shrink the tax base, forcing an increase to the tax rate in order to generate the same amount of money.[3] The increased tax rate actually causes some homeowners to pay more in taxes even though they receive the new exemption.

TAXPAYERS' FEDERATION OF ILLINOIS

NOTES FROM THE INSIDE. . .

By Carol S. Portman

In this issue of *Tax Facts* we revisit one of our historic causes—broad-based, low-rate taxation—through the lens of homestead exemptions from the property tax. Maurice Scholten, our legislative director, estimates the impact of the expansion of homestead exemptions proposed in H.B. 156, using data for taxes paid last year, and it is not as rosy a picture for the average homeowner as some might believe.

Homestead exemptions are popular and proliferating. On the surface, they provide relief to voters complaining about their property tax bills; this is particularly attractive at a time when Illinois' relatively high level of property taxation is becoming more well-known.

Maurice's article reminds us that the property tax is a zero sum game. The nearly $9 billion reduction in the tax base will almost certainly be offset by an increase in tax rates. As a result, taxes saved by homeowners get shifted to non-homeowner properties (rental houses, apartment buildings, commercial or industrial properties) through the higher rates.

And some of that savings gets shifted back onto homeowners. Although a homeowner won't pay tax on the portion of the property covered by the homestead exemption, a higher rate applies to the balance of the home's value. At a certain level of home value, the increased tax rate will actually cost the homeowner more than the increased exemption is saving.

There is no doubt that property taxes in Illinois are high. Homestead exemptions have superficial appeal, but the savings are illusory. They may be good politics, but they are not good public policy.

This article will examine the effect of homestead exemptions by looking specifically at HB 156, but the principles could be applied to any measure that increases homestead exemptions. HB 156 passed the House on April 6 with a vote of 108-1-0. HB 156 as amended (i) increases the general homestead exemption to $8,000 (it is currently $7,000 in Cook County and $6,000 in all other counties); (ii) increases the senior citizen's homestead exemption from $5,000 to $6,000; (iii) creates a statewide long-time homestead exemption for homeowners that have lived in their homes for at least eight years and have an income of $100,000 or less; (iv) creates an assessment freeze for those receiving supplemental security income; (v) creates an exemption of $2,500 for veterans that are 75 years of age or older; and (vi) lowers the minimum disability rating for the disabled veterans exemption to 20%. We analyzed the bill to see how it would affect all property taxpayers, with a focus on the high level effect of the changes. We are not considering the increased burden on assessors, who would need to verify age, income, or disability ratings. **Table 1** shows the estimated EAV reduction caused by each of the exemption changes.[4] We did not estimate an EAV reduction for the new assessment freeze since the EAV reduction in the first year is minimal. However, as years go by, the cost of that exemption will increase.

Table 2 shows the total EAV in the State and by region before and after existing exemptions are applied. It also shows the value of the exemptions under HB 156 and the taxes collected for tax year 2015 which are the

TABLE 1.	
Exemption	**Estimated EAV Reduction**
Increase in General Homestead	$5,170,356,000
Increase in Senior Exemption	$806,381,000
Long-time Homeowner Exemption	$2,569,517,600
75 Year Old Veteran Exemption	$302,387,500
Lowering Disability Threshold	$2,904,062
Total	**$8,851,546,162**

property taxes paid in calendar year 2016. We are assuming that this bill will not affect a taxing district's behavior and they would not lower their levy.[5] In every year since 1975, taxing districts have collected more money than the previous year, with the exception of 1979, which was the first year that all personal property was exempt in Illinois. Throughout this period, various homestead exemptions were created and expanded, but still the total taxes collected increased. Even when the statewide EAV fell 30% between 2009 and 2013, total property taxes increased each year.

Using the EAVs and extensions, we can calculate what the average tax rate would need to be in order to collect the same amount of tax under the different scenarios. We can see in **Table 3 on page 4** that without any homestead exemptions, the statewide average tax rate would be 8.42% rather than the current rate of 9.14%. Furthermore, with the exemption changes in HB 156, the average tax rate would increase to 9.41%. Cook County sees a smaller increase in the tax rate because it sees a smaller general homestead exemption increase, only $1,000 per home instead of the $2,000 increase in all other counties. The higher tax rate means that properties that do not receive a homestead exemption would see their tax bills increase by an average of 2.95%, solely attributable to the expansion of the homestead exemptions. Tax rates in Cook County increase by only 1.62% but they would increase by 5.35% in downstate Illinois. These properties would likely see even higher taxes due to natural increases in tax levies by taxing districts.

TABLE 2.				
Region	**EAV Before Exemptions**	**EAV After Current Exemptions**	**Estimated Value of Exemptions in HB 156**	**Tax Extensions**
Statewide	$341,582,737,847	$314,453,836,484	$8,851,546,162	$28,745,388,566
Cook County	$151,672,060,244	$141,430,912,748	$2,256,313,311	$13,066,967,977
Collar Counties	$102,493,052,545	$95,874,231,703	$2,680,817,015	$8,878,610,719
Rest of State	$87,417,625,058	$77,148,692,033	$3,914,415,836	$6,799,809,869

TABLE 3.				
Region	Tax Rate Without Exemptions	Tax Rate With Current Exemptions	Tax Rate With Exemptions in HB 156	Percentage Increase
Statewide	8.42%	9.14%	9.41%	2.90%
Cook County	8.62%	9.24%	9.39%	1.62%
Collar Counties	8.66%	9.26%	9.53%	2.88%
Rest of State	7.78%	8.81%	9.29%	5.35%

Using these numbers, we can see what the impact would be on an individual homeowner that just receives the general homestead exemption. We'll look at a house in a collar county with a market value of $200,000. If there wasn't a change in the tax rate, calculating the savings would be easy—multiply the increase in exemption by the tax rate:

$2,000 x 9.26% = $185.20

This would be the same for any house since the value of the house doesn't factor into the calculation.[6] However, as explained above, the tax rate is not static. **Table 4** shows the proposed savings which take into account the changing tax rate. This shows that the actual savings are only $28.93 and not $185.20.

Because of the changing tax rate, there is a point at which a property that just receives the general exemption will actually pay more in taxes. This happens when the incremental tax rate increase multiplied by the taxable EAV is greater than the total tax rate multiplied by the increased exemption amount. **Table 5** shows where this average breakeven point is, using average tax rates for every county. Homes with values higher than these amounts will see a tax increase.[7]

TABLE 4. SAMPLE COLLAR COUNTY HOUSE		
Scenario	Current Law	HB 156
Market Value	$200,000	$200,000
Equalized Assessed Value	$66,667	$66,667
Homestead Exemption	$6,000	$8,000
Taxable EAV	$60,667	$58,667
Rate	9.26%	9.53%
Tax Bill	$5,618.15	$5,589.22
Savings	**$28.93**	

TABLE 5. HOME BREAKEVEN POINT

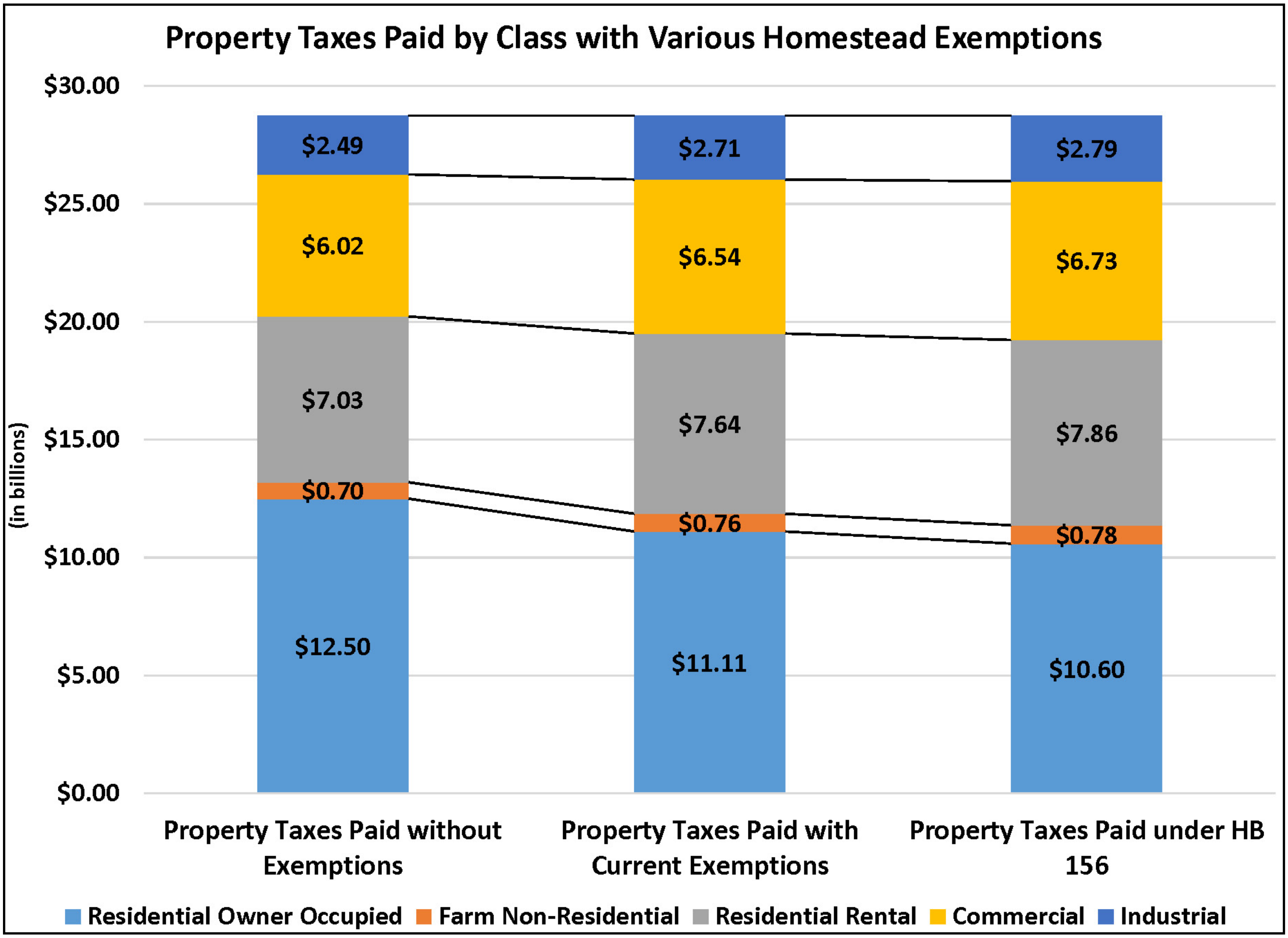
County	Market Value of Home	County	Market Value of Home	County	Market Value of Home
Adams	$131,205	Hardin	$55,518	Morgan	$128,483
Alexander	$69,146	Henderson	$130,419	Moultrie	$129,011
Bond	$110,335	Henry	$127,171	Ogle	$198,525
Boone	$145,750	Iroquois	$125,725	Peoria	$150,091
Brown	$121,174	Jackson	$140,087	Perry	$78,706
Bureau	$122,704	Jasper	$133,749	Piatt	$162,143
Calhoun	$91,617	Jefferson	$103,436	Pike	$105,398
Carroll	$141,518	Jersey	$121,760	Pope	$82,796
Cass	$96,606	JoDaviess	$195,658	Pulaski	$56,499
Champaign	$173,470	Johnson	$83,432	Putnam	$175,517
Christian	$109,436	Kane	$205,205	Randolph	$121,813
Clark	$96,903	Kankakee	$148,176	Richland	$97,764
Clay	$86,301	Kendall	$172,163	Rock Island	$137,562
Clinton	$126,068	Knox	$116,104	St. Clair	$136,891
Coles	$129,661	Lake	$270,761	Saline	$82,114
Cook	$261,129	LaSalle	$164,305	Sangamon	$155,281
Crawford	$158,787	Lawrence	$75,055	Schuyler	$110,360
Cumberland	$99,626	Lee	$145,581	Scott	$99,940
DeKalb	$178,069	Livingston	$147,027	Shelby	$104,377
Dewitt	$228,370	Logan	$137,039	Stark	$149,817
Douglas	$147,041	McDonough	$134,472	Stephenson	$104,605
DuPage	$260,192	McHenry	$170,476	Tazewell	$137,411
Edgar	$133,415	McLean	$195,070	Union	$86,655
Edwards	$78,921	Macon	$118,860	Vermillion	$98,248
Effingham	$153,315	Macoupin	$93,302	Wabash	$99,149
Fayette	$85,762	Madison	$137,442	Warren	$135,607
Ford	$137,980	Marion	$83,010	Washington	$132,274
Franklin	$77,975	Marshall	$145,696	Wayne	$82,681
Fulton	$101,506	Mason	$97,437	White	$96,379
Gallatin	$77,664	Massac	$89,661	Whiteside	$106,423
Greene	$103,866	Menard	$146,079	Will	$204,788
Grundy	$293,092	Mercer	$116,995	Williamson	$125,795
Hamilton	$109,458	Monroe	$154,495	Winnebago	$105,177
Hancock	$115,628	Montgomery	$114,386	Woodford	$157,481

As mentioned earlier, increasing homestead exemptions increases the tax rate and shifts more of the property tax burden onto property owners that don't receive the exemption. That would include commercial property, industrial property, rental property, and farms. **Table 6 below and the graph on page 7** both show how various classes of properties share the property tax burden in three scenarios: if there were no exemptions, with the current exemptions, and then finally with the exemptions in HB 156. (And again, similar results would occur under any proposed increase in exemptions.) The *total* property tax paid for each scenario is the same. We can see, however, that there is a shift of $511 million from residential owner occupied properties to the other classes if current law were to change to HB 156 as proposed.

Increasing homestead exemptions doesn't save homeowners as much as it would appear because tax rates go up. How much the tax rate increases depends on how many properties in the tax base receive the exemptions. Generally speaking, if the tax base is mostly residential, a greater percentage of the properties would receive a homestead exemption, causing a larger increase in the tax rate. In all cases, however, the increased tax rate caused by the increased homestead exemptions has two immediate consequences: it takes away some of the savings of the exemption and it shifts some of the tax burden onto commercial, industrial, and rental properties. If the ultimate policy goal is to reduce property taxes, increasing homestead exemptions simply does not help. Better options would be to provide alternative revenue sources to local governments, have local governments provide fewer services, or both. Proposals that increase homestead exemptions merely mask the problem of high property taxes.

TABLE 6.

Class	Property Taxes Paid Without Exemptions	Property Taxes Paid With Current Exemptions	Property Taxes Paid Under HB 156	Difference Between Current Law and HB 156
Farm Non-Residential	$695,769,532	$755,579,455	$777,457,816	$21,878,361
Residential Rental	$7,032,800,539	$7,637,355,983	$7,858,501,268	$221,145,285
Commercial	$6,020,385,632	$6,537,911,600	$6,727,221,661	$189,310,061
Industrial	$2,493,676,348	$2,708,038,408	$2,786,451,661	$78,413,253
Residential Owner Occupied	$12,502,756,514	$11,106,503,120	$10,595,756,159	-$510,746,960



ENDNOTES

1 https://taxfoundation.org/how-high-are-property-taxes-your-state-2016/

2 For a summary and history of existing homestead exemptions see *Homestead Exemptions: Confusing, Complicated, and Costly* by Kara Moretto. Illinois Tax Facts, Summer 2014 at 1.

3 In some instances, taxing districts may be limited by rate limitations. In unit school districts for example, the education levy cannot exceed 4%. However, school districts subject to the Property Tax Extension Limitation Law ("PTELL") can increase the transportation levy and it has no cap. They can then transfer those funds into the education fund, getting around the rate limit. 87% of extensions come from PTELL counties, so this is a widely available workaround. The transportation levy in non-PTELL school districts is subject to a back-door referendum. Since school districts are the largest taxing body and they can generally maneuver around rate limits, for purposes of this article, we are assuming that taxing districts in general are not constrained by rate limits.

4 All estimates are made using Illinois Department of Revenue statistics for the 2015 tax year plus information from the U.S. Census Bureau.

5 In the certificate of tax levy that taxing districts prepare, they request an amount of money they need for their budget. They do not request a certain tax rate. The county clerk reviews the certificate of tax levy, and based on the final assessed values, determines the required tax rate, and if this rate exceeds a statutory maximum rate, the clerk lowers the rate to the maximum rate permitted by law.

6 The only limitation is that the fair market value of the home must have increased by $24,000 since 1977.

7 Again, these amounts are for homes receiving only the general homestead exemption; homes with other exemptions will have higher break even points.

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