A Critical Review of Property Tax Relief in Wisconsin:
The School Levy Credit and the First Dollar Credit

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Abstract

The State of Wisconsin is currently spending nearly $900 million to fund two property tax relief programs, the *school levy credit* and the *first dollar credit*. This paper provides a detailed analysis of these two credits. The results indicate that the credits provide an inefficient means of delivering property tax relief to Wisconsin homeowners and renters for whom the property tax is creating the greatest economic hardships. The author finds that a substantial proportion of the credits go to non-residents, to high-income individuals, and to others not in serious need of property tax relief. The paper concludes with a recommendation that the two credits be phased out and the resulting budgetary savings be used to help finance the reform of education funding and to expand the homestead credit, an existing income tax provision that provides property tax relief to homeowners and renters facing high property tax burdens.

The major findings of the paper are:

- Despite being labeled as "state support" for education, neither credit provides school districts with any additional financial support for education.

- The existence of the credits may actually encourage local school boards to increase gross property tax levies, although quantifying their impact is difficult.

- The school levy credit provides property tax relief to all owners of property located in Wisconsin regardless of whether the property owners reside in the state.

- Only 51 percent of the total school levy credit reduces property taxes of Wisconsin homeowners on their primary residences.

- Among homeowners, the largest credits flow to owners of expensive homes. Even before receipt of the credits, many of these homeowners face below-average property tax burdens relative to income. Many Wisconsin residents bearing the largest burdens relative to income receive little benefit from the two credits.

- On a per student basis, property owners in the property-wealthiest school districts are allocated school levy credits that are nearly **seven times** larger than those going to property owners in the poorest school districts.

- The first dollar credit results in larger percentage reductions in property taxes for owners of less valuable properties. Nevertheless, the allocation of the first dollar credit to *parcels* results in much higher than the average property relief per student flowing to the property-wealthiest school districts.

About the Author

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Introduction

According to state budget documents, in fiscal year 2010 the Wisconsin state government will spend $6.2 billion in support of public elementary and secondary education, an amount equal to 46 percent of the state's General Fund budget. State statute defines "state support" for education as general and categorical aid paid directly to the state's 425 independent school districts, and property tax relief allocated to property owners through the s*chool levy credit* and the *first dollar credit*.[1]

The school levy credit dates from 1986. For a decade between 1997 and 2006, the annual amount allocated to the school levy credit remained unchanged at $469.3 million. Between 2006 and 2009, the amount of money budgeted for the credit was increased annually. For fiscal year 2009 and for each year of the 2009-11 biennium, $747.4 million has been allocated to the credit. The first dollar credit commenced in fiscal year 2009 with a budget of $75 million. That amount has been increased to $145 million in the first year of the current biennium and $150 million in the second year.

The Legislative Fiscal Bureau has produced an excellent information paper (Runde, 2009) that describes in detail the operation of the school levy and the first dollar credit. However, despite the fact that the two credit programs will cost Wisconsin taxpayers nearly $900 million in each of the next two years, to the best of my knowledge the two credit programs have not been subject to any analysis. The purpose of this paper is to review these programs and in particular to ask whether they are effective and efficient policy instruments for providing the citizens of Wisconsin with property tax relief.

How the Credits Operate

School Levy Credit

The school levy credit received by each taxpayer is determined by a two-stage process. First, the total annual budget for the school levy credit is allocated to municipalities and then each municipality's allocation is divided among all property owners.[2] In the first stage, Wisconsin's 1,850 cities, villages, and towns each receive a tax credit allocation in proportion to their share of the total statewide school property tax levy. To avoid sharp year-to-year changes in municipal allocations, the average school tax levy over the previous three years is used to allocate the credit. For example, the City of Madison's share of the 2009 School Levy Credit is calculated by dividing the average of Madison's school levies between 2006 and 2008 ($204,276,350) by the three-year average of the statewide school levy ($3,828,329,232). Madison's 2009 school levy credit allocation of $29.9

[1] State support also includes a small appropriations for the state Program for the Deaf and for the Center for the Blind.

[2] In some cases, the credit allocations are made to county government instead of municipalities. For ease of exposition, the description of the operation of the credit in the text will refer solely to municipalities.

million was calculated by multiplying its share of the total school levy (approximately 5.3 percent) by the $747.4 million budgeted for the school levy credit.

In the second stage, each municipality divides its allocation among all of its property owners in proportion to the assessed value of each parcel. Property tax relief is delivered to each property owner by reducing the school property tax **mill rate** by an amount determined by dividing each municipality's school levy credit allocation by the value of the municipality's property tax base.[3] These mill rates are then used to reduce each taxpayer's property tax bill. Although the dollar amount of the school levy credit received by each taxpayer is noted on property tax bills, the tax bills reflect the school tax owed net of the school levy credit. Using Madison as an example, in 2009, the average gross school mill rate was 9.79. The city's school levy credit allocation resulted in a 1.76 mill rate reduction. Tax bills were then calculated using the net school mill rate of 8.03. Thus, the School levy credit resulted in a $352 tax saving for the owner of property worth $200,000 (.00176 times $200,000), and a tax saving of $880 for the owner of a $500,000 property.

Property tax bills are issued in December of each year. The bills reflect the amount of property taxes requested by the school districts serving the residents of each municipality minus the school levy credits given to property owners. Under current law, the school levy credit allocations are actually paid to municipal (or county) governments the following July. In August these governments forward these state payments to the school districts within their boundaries.

First Dollar Credit

While the size of the school levy credit received by individuals depends on the value of their property, the first dollar credit is paid on the basis of ownership of "improved" parcels of real estate. Thus, a landlord who owned 10 developed properties would generally receive a first dollar credit on each of her 10 parcels. Only unimproved parcels, usually consisting of land with no buildings, are ineligible for the first dollar credit. The credit, which appears as a separate line item on each property tax bill, is calculated as the gross school mill rate applied to a *base property value* determined each year by the Department of Revenue.[4] The base value in fiscal year 2009 was $3,900. The base amount is calculated so that the resulting credits will not exceed the amount appropriated by the legislature ($75 million in 2009).

As an example, in 2009 the owner of each improved parcel within the Madison Metropolitan School District valued at $3,900 or more received a first dollar credit of $38.24.[5] This amount is the product of Madison's gross school property tax mill rate of 9.8 and the base amount of $3,900. Owners of properties in school districts with higher mill rates obviously received larger first dollar credits.

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[3] Property tax rates are always reported in mills, where one mill is one-tenth of one percent.
[4] In the rare case where the value of a parcel was less than the base property value, the actual value of the property is used to calculate the credit.
[5] Parcels valued at less than $3,900 would receive proportionally smaller credits.

The Tax Credits and Education Funding

In 1993 the Wisconsin legislature made a commitment (as part of Act 437) to finance 66.7 percent (later changed to two-thirds) of public school (K-12) revenues. While the U.S. Department of Education's National Center for Education Statistics (NCES) calculates state shares as direct state aid to local school districts as a percentage of total revenue available to school districts from federal, state, and local sources, the Wisconsin legislature chose to develop its own definition of both the numerator and denominator to be used in its "two-thirds" calculation. [6] The statute defines "state support" (the numerator) to include the annual appropriation for the school levy credit. In 2007 the legislature created the first dollar credit and specified that it would be funded through the same appropriation.

Despite the fact that the two property tax credits are classified by the legislature as state support for education, they are unambiguously designed to provide direct property tax relief to the owners of real property. Not a penny of the close to $900 million allocated to the two credits in each year of the current biennium directly provides additional resources to school districts.

That being said, it is possible that the property tax credits encourage school boards to increase education spending. Each fall, after learning how much direct state aid they will receive, school boards across the states make decisions about the size of their budget, and consequently, their gross property tax levy. School board members and administrators may well be aware of the fact that the two property tax credits lower the school property tax payments made by taxpayers. By lowering the cost to taxpayers of any given level of education spending, the credits reduce what economists call the *tax price* of public education. As is true with consumer goods and services, lower prices may increase the demand, in this case, for education. Although quantifying the response is difficult, it is likely that over time school board members approve somewhat higher levels of spending (and gross property tax levies) because taxpayers benefit from the two property tax credits. An increase in the size of the credits, as has occurred in the past few years, may encourage higher spending. Economists measure responses to changes in prices, including tax prices, by measuring *price elasticities*. Although no good estimates exist in Wisconsin, research in other states suggest that education price elasticities are quite low. This implies that while the two property tax credits might encourage additional education spending in Wisconsin, their impact on spending is likely to be quite modest.

[6] The latest available National Center for Education Statistics (2009) indicate that for fiscal year 2007 the state share of education revenue in Wisconsin was 51.6 percent, the local share, 42.6 percent, and the federal share, 5.7 percent.

The Tax Credits as Property Tax Relief

The School Levy Credit

In analyzing any tax or government spending program, it is important to ask several basic questions. These include, is the policy a good use of public dollars, in other words, is it effective in achieving its goals at a reasonable cost? Who benefits from the tax or spending program? Do public dollars flow to those individuals, businesses, or institutions most in need of assistance?

In enacting the school levy credit and the first dollar credit the legislature was undoubtedly responding to constituent complaints about the hardships created by high property tax bills. An oft-heard complaint about the property tax is that because tax liabilities are related to the value of property, the tax liability for some individuals can be high relative to their incomes. Homeowners often complain that rapid year-to-year increases in their property tax bills create significant economic hardships. One way to assess the effectiveness of a tax relief policy is to ask whether the policy targets property tax relief to those who most need it. Although measuring need is a difficult and a subjective matter, one approach is to determine the extent to which property tax relief is targeted to individuals facing high property tax burdens, where burdens are measured as property tax liabilities as a percentage of family income.

Even before looking at the data, an analysis of the mechanism used for allocating credits suggests that they are not at all targeted to Wisconsin homeowners and renters who face high property tax burdens relative to income. First, the allocation of credits to municipalities is proportional to school property tax levies, and these tend to be highest in upper-income suburban communities. Second, within each municipality, the school levy credit is distributed in proportion to the value of all real property. This means that among any type of property, e.g. owner-occupied homes, higher value properties receive larger credits. Data from the Wisconsin Department of Revenue suggests that high value homes tend to be owned by high income households, and property taxes as a share of income generally decline as income rises. This suggests that larger school levy credits are more likely to go to homeowners facing below average gross property tax burdens.

Owners of commercial, manufacturing, and agricultural property also receive school levy credits, regardless of whether the property owners are struggling small businesses or large corporations owned primarily by non-Wisconsin residents. Table 1 displays the percentage distribution of the fiscal year 2009 school levy credit by type of property. The data show that 72.3 percent of the school levy credits go to residential property, with the

Table 1

School Levy Credit by Property Type
Fiscal Year 2009

Property Type	Credit Amount	Percent of Total
Residential	$540,046,760	72.3%
Commercial	$132,698,947	17.8%
Manufacturing	$18,421,840	2.5%
Agricultural	$3,535,353	0.5%
Forest Land	$14,890,377	2.0%
Personal	$17,764,622	2.4%
Other	$20,042,101	2.7%
Total	$747,400,000	100.0%

Source: Author's calculations based on data from the Wisconsin Dept. of Revenue.

Largest part of the remaining 27.7 percent going to the owners of commercial property.[7]

Residential property includes the primary residences of Wisconsin homeowners, all vacant housing units, residential rental property in buildings containing three or fewer units, and second homes owned by both Wisconsin residents and non-residents. Based on 2005 data on property tax payments, 71.1 percent of residential property tax revenue is paid by Wisconsin homeowners on their principal residences (Boldt, Caruth, and Reschovsky, 2009). Multiplying this percentage by the 72.3 percent of the school levy credit paid to owners of residential property indicates that only 51.4 percent of the total school levy credit ends up providing property tax relief to Wisconsin homeowners on their principal residences.

The school levy credit also provides property tax relief to Wisconsin residents who rent and to those who own second homes within the state. The amount of the school levy credit that flows to renters depends on whether tenants pay part or all of the property tax on their rental unit in the form of higher rents. The ability of landlords to pass property tax increases onto their tenants depends on the competitiveness of the rental market. In various locations, especially in the suburbs of the state's metropolitan areas, residential rental markets are likely to be competitive, and landlords serving these markets may find it difficult to shift property tax payments to their tenants. These market conditions also imply that property tax credits on rental housing will primarily benefit landlords. In one of the few empirical studies of the burden of property taxes on rental property, Carroll

[7] As will be discussed in more detail below, apartment buildings with more than 4 units are classified as commercial property in Wisconsin.

and Yinger (1994) find that in the suburban ring of the Boston metropolitan area, landlords are only able to shift about 15 percent of the tax to tenants.

If, however, the supply of rental units is limited or if tenants have little choice as to location, it is likely that tenants bear a large portion of the burden of the property tax. In this case, tenants are likely to receive much of the benefit from the school levy credit. These conditions are most likely to hold in both the state's most urban and most rural areas. Unfortunately, there have been no detailed studies of the residential rental market in Wisconsin. The Department of Revenue's *Tax Incidence Study* (2004) did however made the "plausible" assumption that 65 percent of the property tax (and presumably, the school levy credit) on occupied rental housing was borne by tenants.

Given available data, it is difficult to estimate the share of the total school levy credit that benefits residential tenants and Wisconsin residents who own second homes in the state. However, using as guidance the assumptions and data provided in the DOR's Tax Incidence Study (Appendix 6), I estimate that about 14 percent the total school levy credit benefits residential tenants and 9 percent benefits Wisconsin residents who own vacation property. These numbers, combined with the 51 percent of the credit going to Wisconsin homeowners, imply that approximately 26 percent of the school levy credits go to owners of non-residential property and to non-Wisconsinites who own vacation homes in the state.

As indicated in the introductory section of this paper, the legislature considers the school levy credit to be part of the state's financial support for K-12 education. It is thus reasonable to ask how the credits are distributed to property owners across the state's 425 school districts. With data on the distribution of the credit to municipalities and the distribution of assessed value among school districts within each municipality, I calculated the allocation of the total school levy credit to property owners in each school district. To allow comparison across school districts, I divided these levy credit amounts by the number of students in each district. The results of these calculations are shown in Table 2, which characterizes school districts by their property tax base per student.[8]

The results are striking. Property owners in the poorest school districts (in terms of property wealth) received an average credit equal to $375 per student. The size of the average credit going to taxpayers in school districts with higher levels of property wealth per student increases with district wealth. Property owners in the state's 21 property-richest districts received average per student credits of $2,596, nearly seven times the average credit going to taxpayers in the poorest school districts.

[8] Equalized values for K-8 and union high school districts are adjusted in accordance with Legislative Fiscal Bureau practice to allow for comparison across all types of districts.

Table 2

School Levy Credit per Student, 2008-09
by Equalized Property Value per Student

Equalized Property Value per Student	Number of Districts	Number of Students	Percentage of Students	School Levy Credit per Student
Less than 250,000	3	8,202	1.0%	$375
250,000-324,999	24	22,900	2.7%	452
325,000-400,000	84	203,871	23.7%	573
400,000-499,999	86	221,697	25.8%	656
500,000-749,999	127	250,698	29.1%	929
750,000-999,999	47	106,664	12.4%	1,384
1,000,000-1,999,999	33	37,442	4.4%	1,823
2,000,000 and over	21	8,903	1.0%	2,596
Total	425	860,377	100.0%	$869

Source: Author's calculations using data from the Wisconsin Department of Revenue.

Table 3 provides data on the school levy credit allocation per student in a small sample of the state's school districts. These data clearly demonstrate that property owners (and tenants) in many of the state's poorest central cities receive relatively small allocations of the school levy credit. Many low-income rural school districts (e.g. River-Ridge; Stanley-Boyd) also receive relatively small per student credit allocations, while many high-income suburban communities (e.g. Mequon-Thiensville) benefit from very large per student allocations.

Table 3

School Levy Credit per Student in Selected Wisconsin School Districts, 2008-09

School District	Number of Students	School Levy Credit per Student
Appleton Area	14,472	$686
Beloit	7,183	368
Green Bay Area	20,451	665
Iowa-Grant	761	498
Madison Metropolitan	25,003	1,636
Menomonee Falls	4,117	1,397
Mequon-Thiensville	3,647	2,054
Middleton-Cross Plains	5,870	1,511
Milwaukee	87,140	549
River Ridge	551	571
Stanley-Boyd Area	964	438
Superior	4,906	597
State Average		$869

Data from Wisconsin income tax returns indicates that, not surprisingly, homeowners with higher incomes tend to live in more expensive houses. This suggests that higher levy credits are going to taxpayers with higher incomes. Although there remain disagreements among economists with regard to the degree of regressivity of the residential property tax, there is some empirical evidence that in Wisconsin homeowners with lower incomes devote a larger share of their incomes to property tax payments than homeowners with higher incomes (Boldt, Caruth, and Reschovsky, 2009).[9] The data in Table 2 suggest strongly that rather than targeting property tax relief to taxpayers facing the highest property tax burdens, the school levy credits appear to provide the largest tax reductions to taxpayers facing the smallest property tax burdens.

[9] This regressivity is only enhanced when account is taken of the fact that many middle and high income homeowners can deduct property tax payments in calculating their federal income tax liabilities.

The First Dollar Credit

The first dollar credit provides tax reductions to most owners of property located in Wisconsin. Although it is counted by the state as "state support" for education, like the school levy credit, the first dollar credit provides no direct aid to school districts.

Within any given municipality, the first dollar credit provides the same dollar amount of property tax relief to the owner of each parcel. This implies that owners of low-value parcels receive larger percentage tax reductions than owners of more valuable parcels. Individuals who own multiple parcels, for example, vacation homes, receive larger credits. As described above, the size of the credit on each parcel is proportional to the school mill rate. Thus, property owners in communities with above-average school mill rates receive above-average first dollar credits.

Parallel to the analysis of the school levy credit presented in Table 2, I calculated the allocation of the first dollar credit to property owners in each school district divided by the number of students per district. The somewhat unexpected results are presented in Table 4. They indicate that the average first dollar credit per student is smallest in the property-poorest districts and largest in the property-wealthiest districts. Despite these extreme values, it is important to emphasize that the average credit per student is quite similar in the vast majority of school districts. The average credit is low in the poorest districts because the average school mill rate in these districts is relatively low, 8.02 in 2009 compared to the statewide average mill rate of 8.62. Even though most property wealthy districts have low mill rates, their above average per student allocations of first dollar credits may reflect the fact that many property wealthy districts include large numbers of vacation and retirement homes and other non-residential properties relative to primary residences with school-age children. As the first dollar credit is distributed to owners of real estate parcels rather than to resident property owners, on a per student basis, the allocation of first dollar credits is larger in school districts with heavy concentrations of recreational property.

Conclusions and Policy Recommendations

State policymakers should continuously question whether state programs are performing well and are achieving their objectives in a cost-effective manner. This critical assessment of all state programs, on both the revenue and spending side of the budget, is particularly important in the current fiscal environment. Recent estimates suggest that state governments around the country will face very large budget gaps over the next few years (McNichol and Johnson, 2009). Wisconsin's fiscal prospects are not rosy. In July 2009, the Wisconsin Legislative Fiscal Bureau (LFB) estimated that the state government will face a "structural imbalance" of $2.05 billion at the beginning of the 2011-13 biennium. Lower expected revenues since then, plus higher than anticipated costs in some government programs suggest that the actual fiscal imbalance will be larger.

Table 4

First Dollar Credit per Student, 2008-09
by Equalized Property Value per Student

Equalized Property Value per Student	Number of Districts	Number of Students	Percentage of Students	First Dollar Credit per Student
Less than 250,000	3	8,202	1.0%	$59
250,000-324,999	24	22,900	2.7%	72
325,000-400,000	84	203,871	23.7%	75
400,000-499,999	86	221,697	25.8%	75
500,000-749,999	127	250,698	29.1%	86
750,000-999,999	47	106,664	12.4%	99
1,000,000-1,999,999	33	37,442	4.4%	130
2,000,000 and over	21	8,903	1.0%	177
Total	425	860,377	100.0%	$84

During the current biennium, Wisconsin taxpayers are spending nearly $900 million per year on the school levy and first dollar credits. Given the current fiscal situation, it is particularly important that we ask whether this money is well spent. In this paper, I have provided evidence to suggest that the two credits are poorly designed to provide property tax relief to those Wisconsin homeowners and renters for whom the property tax is creating a real economic hardship. In fact, not only are substantial proportions of the credits being paid to non-Wisconsin residents, but much of the money is being used to reduce property taxes for high-income homeowners and for other property owners for whom the property tax create little, if any, economic hardship.

Based on these findings, I recommend that the legislature phase out the two credits. As the credits have been counted as state support for education, a strong case can be made for using a significant portion of the cost of the credits to help finance a major reform of the Wisconsin school funding system.[10] The recent cuts in state education aid, the need to replace federal stimulus funds used to finance education in the current budget, and the state's commitment to increase its efforts to reduce student achievement gaps, all suggest how important it is to increase education funding.

[10] For a discussion of the current funding system and an analysis of its shortcomings, see Reschovsky (2008).

I would also recommend that a portion of the $900 million annual cost of the two credits be used to expand the funding of property tax relief tightly targeted to taxpayers facing particularly high property tax burdens. Although all property owners would welcome lower property taxes (as long as public services were not reduced), an effective property tax relief policy should utilize limited state resources to provide property tax relief to Wisconsin residents for whom the property tax is causing substantial economic hardship. In a recent study of Wisconsin homeowners using detailed data from Wisconsin income tax returns, Boldt, Caruth, and Reschovsky (2009) found that the burden of the property tax and any economic hardships it creates vary tremendously among homeowners. While some face both high and increasing property tax burdens, for others the property tax is relatively low and in some cases falling over time.

One effective way of targeting property tax relief to those who need it most would be to reform the state's existing *homestead credit*. Unlike the two credits discussed in this paper, the homestead credit is part of the state's individual income tax. It is a refundable credit that is available to Wisconsin residents with incomes below $24,500 who face high property taxes relative to their current incomes. Although this type of credit, known as a "circuit breaker," is in principle an effective way of targeting property tax relief to those who need it the most, Wisconsin's existing homestead credit has two major deficiencies.

First, the relatively low income limit means that very few Wisconsin households are eligible for the credit. Although renters as well as homeowners can apply for homestead credits, in fiscal year 2009 only about 231,000, or 9.3 percent of returns claimed a credit.[11] Second, the maximum amount of property tax subject to the credit is capped at $1,450, and the maximum homestead credit is limited to $1,160. Given the nature of the formula used to calculate the homestead credits, most actual credit amounts are substantially below the maximum. In fiscal year 2009, the average homestead credit was $525, and total homestead credit claims were $121 million, an amount that is a mere 1.9 percent of the $6.3 billion in residential property tax paid in that year.

One way to increase the reach of the homestead credit would be to raise the property tax ceiling, increase the maximum allowable credit and by raise the income eligibility limit. Opponents to expansion of the homestead credit may argue that such an expansion would be unconstitutional as it would run counter to the *uniformity clause* in Wisconsin's constitution (article VIII, section 1) which requires that all types of property be taxed in a uniform manner. Although the uniformity clause would certainly prevent the removal of the income eligibility limit or raising it to cover a large share of Wisconsin taxpayers, the Wisconsin Supreme Court has ruled that the homestead credit is constitutional because it is a "welfare" rather than a "tax" statute. In *McManus v. Wisconsin Department of Revenue* (1990), the Wisconsin Supreme Court ruled that the state's Farmland Preservation Credit, which at the time of the ruling had an income eligibility ceiling of $38,429, was not in conflict with the constitution's uniformity clause. Adjusting for inflation the income ceiling that was sanctioned by the court in its 1990 *McManus* ruling would presumably justify an income ceiling in 2009 of approximately $60,000.

[11] In calculating the percentage of returns including homestead credit claims, I excluded all returns filed by single filers who qualify as dependents.

An expansion of the homestead credit would go a long way to providing real property tax relief to those Wisconsin residents most in need of assistance with their property tax payments, but at a fraction of the cost of the school levy and first dollar credits.

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