IACIR White Paper #1

HB 1297: Auto Excise Tax and Police/Fire Pension Reform

by

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PREFACE

The **Indiana Advisory Commission on Intergovernmental Relations** was established by the General Assembly in 1995 to provide a forum to work through the problems that naturally will arise as greater demands are made on state and local governments. The Indiana legislation was based upon federal and other states' enabling statutes.

The Indiana Advisory Commission on Intergovernmental Relations is launching an effort to improve intergovernmental decision making and partnerships by serving as a forum for discussion and resolution of intergovernmental problems and concerns. The mission of the Indiana Advisory Commission on Intergovernmental Relations is to create affective communication, cooperation, and partnerships between the federal, state, and local units of government in order to improve the delivery of services to the citizens of Indiana through:

- A better understanding of the process of government and the intended and unintended outcomes of policy decisions;
- Improved communication between all levels of government and citizens;
- The promotion of long-term planning between all levels of government; and
- Applied research on policy areas in order to better understand the impacts of mandates and policy changes.

Section 12 of the statute establishing the Indiana Advisory Commission on Intergovernmental Relations names the Indiana University **Center for Urban Policy and the Environment** to administer the commission.

The mission of the Indiana University Center for Urban Policy and the Environment, as a part of the **School of Public and Environmental Affairs,** is to work with state and local governments and their associations, neighborhood and community organizations, community leaders, and business and civic organizations in Indiana to identify issues, analyze options, and develop the capacity to respond to challenges. The Center's expertise is available to provide research and analysis of policy issues, develop community consensus, offer implementation assistance, and evaluate outcomes and outputs.

HB 1297 AND ITS RAMIFICATIONS ON LOCAL GOVERNMENTS

INTRODUCTION

On February 13, 1996, both the Indiana Senate and House passed a bill (HB 1297) that includes provisions concerning the excise tax, additional funding for teacher and local police and fire pensions, and an increase in the homestead credit. Governor Bayh signed the bill into law on February 22 1996. There has been some confusion as to the effect of this bill on local government. **It is the intent of this paper to help local governments understand the ramifications of House Bill 1297.** This paper will concentrate on the provisions concerning the excise tax and the police and fire pensions funding.

EXCISE TAXES

Local governments should be aware of two issues concerning excise taxes. First, *last year*, the legislature passed a bill (HEA 1598) that cut excise taxes through the year 2001. The state made up some of the difference but not all of it, so local governments revenues from excise taxes will not increase as fast as they have in previous years. Second, the bill that was passed *this year* (HB 1297) speeds up those cuts but replaces the lost revenues (from the speed up) to local governments.

Effective January 1, 1971, Indiana began to collect an auto excise tax in lieu of personal property taxes on passenger cars, motorcycles, and small trucks. The excise tax on each vehicle is a function of age and "class," with class determined by the price of the vehicle as calculated by the Bureau of Motor Vehicles under its rule-making authority. While collected by state license branches, the excise tax is strictly a local tax. The revenues are allocated to the taxing district in which the vehicle registrant resides. The revenues are then distributed to the taxing units of that taxing district in the same manner and at the same time that property taxes are distributed. After property taxes, the auto excise tax is a significant source of revenue for local government and school corporations.

Last year the legislature passed a bill (HEA 1598) that reduced the amount of excise tax to be paid by vehicle owners in 1996 (as compared to 1995) by as much as $70. In addition, for each year until 2001, the tax will decrease further until, in 2001, it will be 50 percent of the 1995 rates for excise taxes above $100; reduced to $50 for those from $51-$99; and held constant for those below $50. That bill also added gaming revenues to the lottery revenues as a funding source to the Motor Vehicle Excise Tax Replacement Account. This fund makes up a portion of the difference between what the localities would have received at the 1995 rates and what they will receive under HEA 1598.

According to estimates made by the Legislative Services Agency, the annual growth rate of the taxes collected will decrease from approximately five percent each year, to between one and two percent each year (see Table 1). The local governments and schools will not see any reduction in revenue from the previous years but the *decrease in the growth rate* (shown in millions of dollars in Table 1), from 1996 to 2001, will cost local governments a total of $464 million. However, the tuition support formula will replace the lost excise revenue in the school general fund, bringing the total loss down to $318 million over the six-year period.

Table 1
Fiscal Effect of HEA 1598 on Local Governments
($ millions)

Year	Local Gov Growth Reduction Law HEA 1598 (95)	Growth Rate Under Pre-1996 Law	Growth Under HEA 1598 (95)
1996	$17.3	5.46%	1.04%
1997	29.9	5.22%	1.92%
1998	44.6	5.10%	1.67%
1999	59.6	4.99%	1.73%
2000	76.1	4.89%	1.73%
2001	91.5	4.79%	1.64%

Source: Legislative Services Agency Estimates 2/2/96

HB 1297 retroactively applies to the 1996 registration year of the motor vehicle excise tax schedule applicable to registration years beginning after the year 2000. This means that the highest cut in the tax rate will be effective in 1996 instead of in 2001. As Table 2 illustrates, local governments will receive the same amount they would have received under HEA 1598. The difference of $300 million between the excise tax under HEA 1598 and the 1996 phase-in will be provided automatically each year from the state's general fund. HB 1297 does not return local governments to the level of funding they would have received prior to HEA 1598. However, HB 1297 makes these new excise cuts revenue neutral to local governments (*see Excise Tax Example*).

Table 2
Effect of Accelerated Motor Vehicle Excise Tax Rate Decrease
($ millions)

Year	Local Rev Pre-HEA 1598 & HB 1297	Excise Tax Under HEA 1598 (95)	Excise Tax Under 1996 Phase-In	Local Rev Under HEA 1598 (95) & 1996 Phase-In
1996	$576.9	$432.7	$319.3	$552.7
1997	607.0	423.1	335.8	563.3
1998	637.9	412.6	351.3	572.7
1999	669.7	402.4	369.0	582.6
2000	702.4	392.2	387.7	592.7
2001	736.1	407.1	406.9	607.1

Source: Legislative Services Agency estimates 2/2/96

Excise Tax Example

To illustrate the effects of the two bills on excise tax revenues, imagine a community that received $100,000 in local revenue from the excise tax in 1995. Under HEA 1598, their revenues in 1996 would grow to $101,040. If that bill had not become law, and the rates had stayed the same, that community would have received $105,460 in 1996. Under HB 1297 that community will still receive $101,040, even though taxpayers will be paying less excise tax. The state will pick up the difference.

POLICE AND FIRE PENSION RELIEF

HB 1297 creates an $180 million pension relief fund, at no cost to local governments, targeted to the most distressed communities (local communities whose net pension payments are more than ten percent of their property tax levy).

Before 1977, cities and towns paid the pensions of their police and firefighters as they came due. In 1977, this was changed when the state created an actuarially funded plan, managed centrally by the Public Employee Retirement Fund (PERF) at the state level. Local governments under the new plan make an annual payments to the state of 21 percent of the police and fire payrolls, with the active members contributing six percent. The state legislature recognized the burden that local governments would face since they were still responsible for the benefit payments under the old plan, as well as under the new plan, and created the Pension Relief Fund (PRF). They directed increased cigarette and liquor taxes, and later lottery revenues into this fund, from which distributions are made to cities and towns. This fund helps cities and towns meet their old plans' benefit obligations. After a certain percentage increase from one year to the next is reached in the distribution amount, the PRF picks up the additional burden. This percentage is recalculated each year and has been nearly ten percent for the past three years.

In 1981, the General Assembly created a new formula (called "M") and distribution that took into account not only the increasing liabilities under the old plan but the costs of the new plan (after 1977). The increase in both payments is compared to the increase in all units budgets. If net current pension costs for both plans grow faster than the budget, a distribution may be made under the formula. Since 1982, only six M distributions have been made, totaling $10.32 million. The M portion of the PRF has now grown to a balance of $130 million. It is funded from the excess earnings of the Pension Relief Fund. Its earnings are capped at six percent. All interest earned above that goes into the M portion of the fund.

HB 1297 creates a $180 million pension relief fund for police and fire pensions with a one-time appropriation of $50 million in combination with the current balance of $130 million in the M portion of the pension relief fund. This fund is targeted to the most distressed cities and towns. It changes the allocation formula for the current pension relief fund from one that allocated funds to every unit, to one that targets distressed communities. If the city's net pension payments, after distributions from the pension stabilization fund, are more than ten percent of their property tax levy, the unit is eligible for a distribution from the pension relief fund. The relief is focused on cities with large increases in city pension payments, allowing units to freeze those payments to their current percentage of the maximum levy. Actuaries for the police and fire funds estimate that 105 municipalities will receive distributions from this newly created fund.

Teachers Pensions

The 1995 session created a program to stabilize the state's general fund teacher pension expenditures as a percentage of the general fund budget. It established the pensions stabilization fund to achieve this goal. HB 1297 makes a one-time appropriation of $200 million to the pension stabilization fund of the Teacher's Retirement Fund from the State General Fund. This appropriation is in addition to the ongoing appropriations made under the budget bill (from the lottery, etc.)

Homestead Credit

Another provision of this bill increases the percent of homestead credit paid by the state from the current rate of four percent to eight percent in calendar year 1996, decreasing to six percent in 1997, and returning to four percent in 1998. This credit is fully funded by the state.

Conclusion

HB 1297 has a total positive effect on local governments. The negative effect of the reduction in excise taxes on local government was included in the bill that was passed last year (HEA 1598) and is now state law. The excise tax provisions in the current bill are revenue neutral to local governments. The new pension relief fund is a positive gain for local governments. There will be an additional $180 million available to approximately 105 municipalities to help them with their excess pension payments, at no cost to the local governments.

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