

ECONOMIC BRIEF NO. 19

Circuit Breakers & Tax Relief

This series of economic briefs explores fundamental concepts in economics and community and economic development.

The property tax is a tax on wealth and not on income. That can cause problems. Older homeowners with limited or fixed incomes sometimes have wealth in the form of houses or land that is worth a great deal on paper. If the house is taxed on the basis of its fair market value, they may have difficulty coming

short of eliminating property taxes. One alternative used in 35 states is something called a circuit breaker.

How does a circuit breaker work? It sets an upper limit on the percent of income that a residential homeowner is required to pay in taxes on an owner-occupied residence. If the

whose property taxes are high relative to income.

The present South Carolina homestead exemption for the elderly provides tax relief to everyone over 65, but not everyone over 65 has low incomes and high property taxes. Those younger than 65 get no relief whatever their need. Targeting property tax relief to those who need it is much less expensive than cutting everyone's property taxes in order to reach the poor.

Circuit breakers do not solve all the problems with the property tax. The property tax still can be inequitable, and it still would be payable annually in a lump sum. Circuit breakers can be hard to explain because they are more complicated than homestead exemptions or tax credits. But if the big concern over property taxes is lower income young families or retired couples whose taxes are out of line with their incomes, the circuit breaker is an efficient way to address the problem.

The following example illustrates one way a circuit breaker might be structured. Suppose the threshold for the circuit breaker is two percent of income and a homeowner has an annual income of \$30,000. Under the circuit breaker this taxpayer's property tax liability could not exceed \$600 ($\$30,000 \times .02$). The homeowner would pay the \$1,000 and then file for a refund of \$400, the amount above the circuit breaker, on his or her state income tax.

up with the cash to pay the taxes. At the extreme, they may have to put the house on the market to obtain the cash needed for taxes.

No one likes to see people forced out of their homes of a lifetime because they cannot afford the property taxes. That possibility is one reason there is so much political activity to eliminate property taxes in South Carolina.

But there are alternatives that address this problem

property tax bill is in excess of that percentage, the homeowner gets a refund for the excess. The actual outlay in property taxes is limited to whatever percentage of income is below the circuit breaker threshold.

There are all kinds of bells and whistles that can be attached to circuit breakers, including relief for renters or a ceiling on the refunded amount. Each state's circuit breaker is a little bit different, but all target persons

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