Indiana Tax Incentive Review

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Preface

IC 2-5-3.2-1 establishes an annual review, analysis, and evaluation process for state and local tax incentives. The annual review will be conducted over a five-year cycle during which each state and local tax incentive will be reviewed at least one time. The annual tax incentive review is conducted by the Office of Fiscal and Management Analysis, Legislative Services Agency, under the direction of the Interim Study Committee on Fiscal Policy. An annual report of the tax incentive review must be submitted by the Interim Study Committee on Fiscal Policy to the Legislative Council. Since the five-year review cycle begins in 2014, the initial tax incentive review and report must be completed during the 2014 legislative interim. Pursuant to IC 2-5-3.2-1, this report:

- Identifies the tax provisions that will be subject to review from 2014 to 2018.
- Specifies the five-year review schedule.
- Provides fiscal impact estimates of each tax provision for FY 2016 and FY 2017 (CY 2015 and CY 2016 for property tax provisions).
- Reviews, analyzes, and evaluates the following tax provisions:
    - Home insulation deduction
    - Solar-powered roof vent/fan deduction
    - Indiana partnership long-term care insurance premiums deduction
    - Medical savings account contributions deduction
    - Homeowner’s property tax deduction
    - Renter’s deduction
    - Personal exemption
    - Dependent exemption
    - Dependent child exemption
    - Elderly/blind exemption
    - Low-income elderly exemption
- Provides descriptive information and data relating to the tax provisions subject to review in 2014.
- Analyzes and evaluates the effectiveness and economic impacts of the tax provisions subject to review in 2014.

We would like to acknowledge the Indiana Department of State Revenue for its assistance in providing annual income tax data that is presented and analyzed in this report.

Introduction

A tax incentive is a provision of the tax code aimed at encouraging a taxpayer to conduct specified activities or undertake certain behavior by reducing the taxpayer's tax liability in relation to the targeted activity or behavior. Over the course of the last 30 to 40 years tax incentives have become a significant and growing part of local tax laws, state tax codes, and the federal Internal Revenue Code. At the forefront of this expansion in tax incentive use has been the growth in the number and scale of economic development tax incentives tied to business employment, wages, and investment. In contrast to direct spending programs, tax incentive programs direct public funding to certain purposes by foregoing tax revenue. Moreover, tax incentive programs are different than direct spending programs because tax incentives typically are not subject to the periodic scrutiny that direct spending programs are subject to through the normal budgetary process. During this 30-to-40 year period a robust literature has also developed examining these tax policies.[1] This literature comprises the following:

- Surveys of business leaders relating to the impact of state and local taxes on business location decisions.
- Econometric research examining the link between state and local tax levels and business locations, business investment, gross state product, and the like.
- Econometric research examining the effectiveness of specific tax incentives (such as investment tax credits) on capital investment, employment, and wages.
- Econometric and other research examining the effectiveness of incentive programs like enterprise zones, tax increment financing, and the like.

The PEW Center on the States indicates that "[it's] research reveals that lawmakers often approve or continue incentives without knowing their potential cost or whether they are working."[2] PEW also suggests that "[s]tate leaders need better information to avoid unexpected budget challenges, identify effective incentives, and reform or end programs that are not meeting expectations." PEW's 2012 report *Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth* suggests that only about one fourth of the states do intensive tax incentive analysis, while another one fourth of the states examine incentives to a lesser extent with mixed results. The report suggests that half the states essentially take little or no action to examine tax incentives.

Responding to these circumstances, a number of states have recently initiated tax incentive review processes to examine the usage, effectiveness, and economic impacts of tax incentives. PEW has been instrumental in helping to initiate and support these state efforts as a part of its Business Incentives Initiative. The purposes of this initiative include the identification of effective ways to assess tax incentive policies, the improvement of state data collection and reporting on tax incentives, and the development of best practices for states relating to data collection and reporting on tax incentives.[3]

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[1] Abravanel, M. D., Pindus, N. M., and Theodos, B. (2010). Evaluating Community and Economic Development Programs: A Literature Review to Inform Evaluation of the New Markets Tax Credit Program. Metropolitan Communities and Housing Center, Urban Institute, Washington, DC. September 2010.

[2] The PEW Center on the States. Economic Development Tax Incentives website. Accessed September 15, 2014. http://www.pewtrusts.org/en/projects/economic-development-tax-incentives.

[3] The PEW Center on the States. Business Incentives Initiative website. Accessed September 15, 2014. http://www.pewtrusts.org/en/about/news-room/news/2014/04/08/the-business-incentives-initiative.

Tax incentives have been examined in Indiana prior to the current program. Indiana initiated a review of state tax credits, including many incentives, under HEA 1072-2012. This act required the Commission on State Tax and Financing Policy to conduct a study of all income tax credits during the 2012 and 2013 legislative interims. The Commission held two hearings during the 2012 interim and one hearing during the 2013 interim to receive tax credit reviews prepared by the Office of Fiscal and Management Analysis, Legislative Services Agency.[4]

Tax Incentive Review Process

IC 2-5-3.2-1, which was enacted in HEA 1020-2014, establishes an annual review, analysis, and evaluation process for state and local tax incentives. Appendix 1 contains a copy of IC 2-5-3.2-1. The tax incentive review is conducted by the Office of Fiscal and Management Analysis, Legislative Services Agency, under the direction of the Interim Study Committee on Fiscal Policy.[5] The annual tax incentive review is to be conducted over a five-year cycle with each tax incentive being reviewed at least one time during that review cycle. A multi-year review schedule specifying the year in which each tax incentive will be reviewed must be developed and published by November 1, 2014.

The five-year review cycle must be conducted twice. The first five-year review cycle begins during the 2014 legislative interim and will be completed with the tax incentive review conducted during the 2018 interim.

A report containing the results of the annual tax incentive review must be submitted to the Legislative Council by November 1 each year. Consequently, the first of these reports covering the 2014 tax incentive review must be submitted to the Legislative Council by November 1, 2014.

Also under this statute, the Interim Study Committee on Fiscal Policy must hold public hearings to receive information concerning tax incentives. The Committee held a hearing to receive a status report on the tax incentive review and information on tax incentives on September 30, 2014.[6]

Tax Provisions to be Included in the Tax Incentive Review

IC 2-5-3.2-1 defines a tax incentive as a benefit provided through a state or local tax that is intended to alter, reward, or subsidize a particular action or behavior by the tax incentive recipient, including a tax incentive providing a benefit intended to encourage economic development.

A tax incentive includes an exemption, deduction, credit, preferential rate, or other tax benefit that reduces a taxpayer's state or local tax liability or results in a tax refund. A tax incentive also includes a program where revenue is dedicated by a political subdivision to pay for improvements in an economic or sports development area, a community revitalization area, an enterprise zone, or a tax increment financing district.

[4] The 2012 Tax Credit Reviews are at https://iga.in.gov/documents/7debe6a3, and the 2013 Tax Credit Reviews are at https://iga.in.gov/documents/10b6841c.

[5] HEA 1020-2014 specified the Commission on State Tax and Financing Policy or its successor committee. The Commission was repealed under SEA 80-2014. Legislative Council Resolution 14-01 assigned the tax incentive review to the Interim Study Committee on Fiscal Policy, which was established by SEA 80-2014.

[6] Information from the September 30, 2014, hearing of the Interim Study Committee on Fiscal Policy is available at: https://iga.in.gov/legislative/2014/committees/i_fiscal_policy_interim_study_committee_on.

Tax Incentive Review Purposes and Approaches

IC 2-5-3.2-1 essentially specifies that the purpose of the annual tax incentive reviews is to: (1) ensure tax incentives accomplish the purposes for which they were enacted; (2) include the cost of tax incentives in the biennial budgeting process; and (3) provide information needed by the General Assembly to make policy choices about the efficacy of tax incentives. IC 2-5-3.2-1 lists a variety of descriptive and analytical information that could accomplish these tax incentive review goals. This information is as follows:

- The attributes and policy goals of the tax incentive.
- The tax incentive's equity, simplicity, competitiveness, public purpose, adequacy, and conformance with the purposes of the legislation enacting the incentive.
- The activities the tax incentive is intended to promote and the effectiveness of the tax incentive in promoting those activities.
- The number of taxpayers applying for, qualifying for, or claiming the tax incentive, and the tax incentive amounts (in dollars) claimed by taxpayers.
- The tax incentive amounts (in dollars) claimed over time.
- The tax incentive amounts (in dollars) claimed by industry sector.
- The amount of income tax credits that could be carried forward for the ensuing five-year period.
- An estimate of the economic impact of the tax incentive, including a return on investment calculation, cost-benefit analysis, and direct employment impact estimate.
- The estimated state cost of administering the tax incentive.
- The methodology and assumptions of the tax incentive review, analysis, and evaluation.
- The estimated leakage of tax incentive benefits out of Indiana.
- Whether the tax incentive could be made more effective through legislative changes.
- Whether measuring the economic impact of the tax incentive is limited due to data constraints and whether legislative changes could facilitate data collection and improve the review, analysis, or evaluation.

Tax Incentive Review Report

IC 2-5-3.2-1 requires the Interim Study Committee on Fiscal Policy to submit a report to the Legislative Council containing the results of the annual review, analysis, and evaluation of tax incentives. The report must be submitted on or before November 1 each year beginning in 2014. The report must include at least the following components:

- A detailed description of the review, analysis, and evaluation of each tax incentive reviewed during that year.
- Recommendations about the continuation, modification, or termination of each reviewed tax incentive and the better alignment of each reviewed tax incentive with its original legislative intent.
- A cost estimate for each fiscal year of the next biennium for each tax incentive scheduled for review during the five-year review cycle as well as the total cost of the tax incentives.
- To the extent possible, an estimate of the indirect economic benefit or activity stimulated by each reviewed tax incentive.

The fiscal impact estimates for the tax incentives are to be provided to the chairperson and ranking minority member of the House Committee on Ways and Means and the Senate Committee on Appropriations for use in the preparation of the budget and to the General Assembly to be used in the budget process. The statute requires the General Assembly to use the report to determine whether a particular tax incentive: (1) is successful; (2) is provided at a cost that can be accommodated by the state's biennial budget; and (3) should be continued, amended, or repealed.

Tax Incentive Review Schedule

Table 1 specifies the tax incentives and nonincentive tax provisions scheduled for review during the 2014 interim. The remaining schedule for 2015 to 2018 is specified in Table 2 at the end of this section. A total of 128 tax provisions and 6 economic development programs are scheduled for review from 2014 to 2018. The tax incentives and nonincentive provisions included on the review schedule are associated with the corporate income tax and individual income tax (54 tax provisions), the property tax (51 tax provisions), the sales tax (20 tax provisions), and other taxes (3 tax provisions). The 6 economic development programs are tax increment financing (TIF), enterprise zones (EZs), community revitalization enhancement districts (CREDs), professional sports development areas (PSDAs), certified technology parks (CTPs), and the motor sports development district. The full list of tax incentives and nonincentive tax provisions on the review schedule, including descriptions, is contained in Appendix 2.

There are several caveats to the review schedule. The most important relates to the breadth of tax provisions included on the review schedule. Not only does IC 2-5-3.2-1 require tax incentives to be analyzed and evaluated, it requires the annual report of the review, analysis, and evaluation to contain a tax expenditure report. This is included in IC 2-5-3.2-1(d)(4) which requires fiscal impact estimates to be done on all tax incentives for the ensuing biennial budget period.[7] Because of these tax expenditure reporting requirements, the list of tax provisions subject to review is currently very broad and includes tax incentives as well as exemptions, deductions, and credits that are not tax incentives. Roughly 40% of the tax provisions included on the five-year review schedule are not tax incentives but nonetheless are tax provisions with a significant fiscal impact.

Table 1: Tax Incentives and Nonincentive Provisions Scheduled for Review in 2014

Year of Review	Tax	Tax Provision
2014	Individual Income Tax	• Dependent Child Exemption • Dependent Exemption • Elderly/Blind Exemption • Low-Income Elderly Exemption • Personal Exemption • Home Insulation Deduction • Homeowner's Property Tax Deduction • Indiana Partnership Long-Term Care Insurance Premiums Deduction • Medical Savings Account Contribution Deduction • Rent Deduction • Solar-Powered Roof Vent/Fan Installation Deduction

[7] A tax expenditure is a broader concept than that of a tax incentive. A tax incentive is a tax exemption, deduction, or credit that is structured to encourage certain activities or behavior from taxpayers. In contrast, a tax expenditure is tax exemption, deduction, or credit that is a deviation from the normal tax structure or tax base. While tax incentives are tax expenditures, not all tax expenditures are tax incentives. The home insulation deduction included in the 2014 incentive review is a tax incentive in that its aim is to encourage additional expenditures by homeowners on insulation projects. The deduction is also a tax expenditure in that it is a deviation from the taxable income base. Conversely, the personal exemption is not a tax incentive, but it is a tax expenditure. Personal exemptions are historically deviations from the taxable income base to achieve the goal of exempting a certain level of subsistence income from the income tax.

A second caveat about the review schedule relates to the length of the 2014 review list. The 2014 review list is much shorter than the annual review lists for 2015 to 2018. In part, this is due to the short time frame between enactment of the legislation in March 2014 and the November 1, 2014, deadline for both the five-year review schedule and the first-year incentive review and report.

The 2014 review list has also been shortened so that the 2014 work program could focus on the development of a robust and high-quality approach that could be used, expanded, and improved during the ensuing years of the tax incentive review program.

From 2015 to 2018, the annual review will consider tax provisions from each major tax (individual income, corporate income, sales, and property). This was done because of the volume of income and property tax provisions which could not be covered in a single year. So the division of tax provisions on the schedule was important for managing the analysis and evaluation work and to ensure high-quality analysis and evaluation each year.

Also, we thought it would be unlikely that legislators and staff would be willing to wait several years to review provisions of one of the state's major taxes (e.g., waiting three years to review sales tax incentives if income and property tax incentives were covered in the first two years of the review).

The review schedule also allows for synergies to be achieved with incentives that are comparable or linked in some way to be analyzed and evaluated at the same time.[8] This will likely improve the research output and make the analysis and evaluation of those tax provisions more informative for legislators and staff.

[8] Examples of synergies include analyzing and evaluating similar incentives together like the home insulation deduction and the solar-powered roof vent/fan installation deduction or analyzing and evaluating incentives that are linked somehow like the EDGE and Hoosier Business Investment credits that tend to be awarded together.

Table 2: Tax Incentive and Nonincentive Provisions Scheduled for Review from 2015 – 2018.

Tax	Tax Provision	
	2015	2016
Corporate Income Tax (C)/ Individual Income Tax (I)	• Civil Service Annuity Income Deduction (I) • Human Services Recipients Deduction (I) • Military Service Income Deduction (I) • National Guard/Reserve Income Deduction (I) • Net Operating Loss Deduction (C)(I) • Unemployment Compensation Deduction (I) • Earned Income Tax Credit (I) • Lake County Homeowner's Property Tax Credit (I) • LOIT Credit for Elderly/Permanently Disabled (I) • Unified Tax Credit for the Elderly (I)	• Enterprise Zone Employee Income Deduction (I) • Hoosier Lottery Winnings Deduction (I) • Law Enforcement Rewards Deduction (I) • Private School/Home School Expenses Deduction (I) • 21st Century Scholars Program Credit (C)(I) • Enterprise Zone Employment Expense Credit (C)(I) • Enterprise Zone Investment Cost Credit (C)(I) • Enterprise Zone Loan Interest Credit (C)(I) • Indiana 529 College Savings Account Contribution Credit (I) • Indiana Colleges/Universities Contribution Credit (C)(I) • Individual Development Accounts Credit (C)(I) • Neighborhood Assistance Credit (C)(I) • School Scholarship Contribution Credit (C)(I)
Property Tax	• Aircraft Deduction • Coal Combustion Product Deduction • Geothermal Energy Heating or Cooling Device Deduction • Hydroelectric Power Device Deduction • Intrastate Aircraft Deduction • Rehabilitated Property Deduction • Rehabilitated Residential Property Deduction • Resource Recovery/Coal or Oil Shale System Deduction • Resource Recovery Systems Deduction • Solar-Energy Systems Deduction • Wind-Power Devices Deduction	• Blind Deduction • Disabled Deduction • Enterprise Zone Investment Deduction • Enterprise Zone Obsolescence Deduction (Marion County) • Low-Income Elderly Deduction • Mortgage Deduction • Service-Connected Disabled Veterans Deduction • Spouse of World War I Veteran Deduction • Standard Deduction • Supplemental Standard Deduction • Totally Disabled Veterans Deduction • Veteran of World War I Deduction • Circuit Breaker Credit • Circuit Breaker Credit - Age 65 and Over • Homestead Credit - COIT • Homestead Credit - LOIT • Homestead/Residential Credit (Inventory Mitigation) - CEDIT • LOIT PTRC - All Property • Residential Credit - LOIT
Sales Tax	• Cargo Trailers/RVs Sold to Certain Nonresidents • Computer Equipment Sold by Schools to Parents • Food for At-Home Human Consumption • Lottery Tickets • Medical Devices and Equipment • Prescription Drugs	• Aircraft Parts • Aviation Fuel • Certain Aircraft • Certain Racing Equipment • Sales by Charitable/Religious/Scientific/Educational Organizations • Sales by Fraternities/Sororities/Student Cooperative Housing Organizations
Utility Receipts Tax	• Resource Recovery Systems Depreciation Deduction	
Other	• Tax Increment Financing	• Enterprise Zones

Tax	Tax Provision	
	2017	**2018**
Corporate Income Tax (C)/ Individual Income Tax (I)	• Disability Retirement Income Deduction (I) • Railroad Retirement Income Deduction (I) • Railroad Unemployment/Sickness Benefit Deduction (I) • Social Security Benefits Deduction (I) • Community Revitalization Enhancement District Credit (C)(I) • Community Revitalization Enhancement District Local Credit (I) • EDGE Credit (C)(I) • Headquarters Relocation Credit (C)(I) • Hoosier Business Investment Credit (C)(I) • Industrial Recovery Credit (C)(I) • 5% Rate for Income Derived on Military Base (C)	• Patent-Derived Income Deduction (C)(I) • Adoption Tax Credit (Effective 2015) (I) • Alternative Fuel Vehicle Manufacturing Investment Credit (C)(I) • Coal Gasification Technology Investment Credit (C)(I) • Historic Rehabilitation Credit (C)(I) • Natural Gas-Powered Vehicles (Effective 2014) (C)(I) • Research Expense Credit (C)(I) • Residential Historic Rehabilitation Credit (I) • Venture Capital Investment Credit (C)(I)
Property Tax	• Cemetery Exemption • Charitable Exemption • Educational Exemption • Fine Arts Exemption • Fraternity/Sorority Exemption • Hospital Exemption • Industrial Waste Control Facility Exemption • Lake/Reservoir Exemption • Literary Exemption • Low-Income Housing Exemption • Low-Income Residence Exemption • Pollution Control Personal Property Exemption • Religious Exemption • Scientific Exemption • Specified Organization Exemption	• Brownfield Revitalization Zone Deduction • Certified Technology Park Deduction • Deduction for Purchases of Investment Property by Recycled Component Manufacturers • Infrastructure Development Zone Deduction • Marine Opportunity District Deduction • Personal Property Abatements in an Economic Revitalization Area • Real Property Abatements in an Economic Revitalization Area
Sales Tax	• Manufacturing, Farming, and Utility Production Inputs • Recycling Inputs • Required Pollution Abatement Equipment • Research and Development Property • Sales by a Utility Used in Manufacturing	• Property Purchased by Telecommunications Service Providers • Property Directly Used in Providing Public Transportation • Type II Gambling Games
Other	• Community Revitalization Enhancement Districts • Professional Sports Development Areas	• Lower Rates for Smaller Riverboats • Promotional Free Play Deduction • Certified Technology Parks • Motorsports Investment District

Fiscal Impact of Tax Incentives

Table 3: Estimated State Revenue Loss from Tax Provisions Reviewed in 2014 (in millions)

Type of Tax Provision	Tax Provision	FY 2016	FY 2017
Incentive	Home Insulation Deduction	$1.1	$1.1
	Solar-powered Roof Vent/Fan Installation Deduction	*	*
	Indiana Partnership Long-Term Care Insurance Premiums Deduction	$1.6	$1.7
Nonincentive	Personal Exemption	$143.4	$144.9
	Dependent Exemption	$69.0	$69.7
	Dependent Child Exemption	$86.4	$87.6
	Elderly/Blind Exemption	$26.1	$26.6
	Low-Income Elderly Exemption	$7.3	$7.3
	Homeowner's Property Tax Deduction	$53.2	$53.2
	Renter's Deduction	$60.8	$60.9
	Medical Savings Account Contribution Deduction	$0.1	$0.1

*Revenue loss is less than $100,000.

The tax incentive review schedule contains tax incentives as well as exemptions, deductions, and credits that are not tax incentives. The prior section included a discussion of the rationale for making the review schedule broad, including not only tax incentives but also nonincentive provisions. This section reports the fiscal impact of the tax incentives and nonincentive provisions subject to review during the 2014 legislative interim. A full listing of the tax incentives and nonincentive provisions and their estimated fiscal impacts is contained in Appendix 3.

Table 3 reports the FY 2016 and FY 2017 state fiscal impacts of the tax incentives and nonincentive

Table 4: Estimated Local Revenue Loss from Tax Provisions Reviewed in 2014 (in millions)

Type of Tax Provision	Tax Provision	FY 2016	FY 2017
Incentive	Home Insulation Deduction	$0.5	$0.5
	Solar-Powered Roof Vent/Fan Installation Deduction	*	*
	Indiana Partnership Long-Term Care Insurance Premiums Deduction	$0.7	$0.7
Nonincentive	Personal Exemption	$60.8	$61.5
	Dependent Exemption	$29.3	$29.6
	Dependent Child Exemption	$36.7	$37.2
	Elderly/Blind Exemption	$11.1	$11.3
	Low-Income Elderly Exemption	$3.1	$3.1
	Homeowner's Property Tax Deduction	$22.6	$22.6
	Renter's Deduction	$25.8	$25.8
	Medical Savings Account Contribution Deduction	*	*

*Revenue loss is less than $100,000.

provisions subject to review during the 2014 interim.

Table 4 reports the FY 2016 and FY 2017 local fiscal impacts of the tax incentives and nonincentive provisions subject to review during the 2014 interim. The local fiscal impacts result because local option income taxes (LOIT) use the same taxable income base as the state individual income tax, and exemptions and deductions reduce this taxable income base. The fiscal impact estimate assumes the current statewide median LOIT rate of 1.4%.

Effectiveness and Economic Impact of Tax Incentives

The approach we use for the review, analysis, and evaluation of tax incentives considers a variety of information and evidence, such as the following:

(1) The statute establishing the tax incentive.
(2) The legislative history of the statute establishing the tax incentive.
(3) Utilization of the tax incentive by taxpayers as measured by the number of taxpayers claiming the tax incentive annually and the tax incentive amounts claimed.
(4) The income distribution of tax incentive claims.
(5) The impact of the tax incentive on tax liability of tax incentive claimants.
(6) The impact of the tax incentive on the cost of the activity targeted by the tax incentive.
(7) Other relevant data, data analysis, and research that could potentially be used to conclude whether the tax incentive effectively encourages the targeted activity.
(8) Input-output analysis employing the IMPLAN regional economic model to estimate the impact of spending activity induced by a tax incentive on employment, income, and output in Indiana.

The tax incentives we review using this approach are the: (1) home insulation deduction, (2) solar-powered roof vent/fan installation deduction, and (3) Indiana Partnership long-term care insurance premiums deduction.

For the nonincentive tax provisions reviewed in this report, we provide an expedited review which explains the tax provision and reports information on the utilization, income distribution, and tax liability impact of the tax provision. The nonincentive provisions that receive an expedited review are the: (1) personal exemption, (2) dependent exemption, (3) dependent child exemption, (4) elderly/blind exemption, (5) low-income elderly exemption, (6) homeowner's property tax deduction, (7) renter's deduction, and (8) medical savings account contribution deduction.

Home Insulation Deduction

(IC 6-3-2-5)

- Enacted in 1978; effective in 1979
- Deduction equals up to $1,000 of the material and professional installation costs

Background

The Home Insulation Deduction was established as an incentive for taxpayers to install new insulation in their homes. The deduction equals up to $1,000 of the material and professional installation costs. The deduction was enacted in 1978 and went into effect in 1979. The monetary limit on the deduction has not changed since it was enacted.

The deduction reduces the taxpayer's Indiana adjusted gross income before the application of the income tax rate. The tax savings from the deduction equals the deduction amount multiplied by the tax rate. Consequently, the maximum $1,000 deduction will reduce the state income tax liability by $34 and the local option income tax (LOIT) liability by $14 based on the median LOIT rate of 1.4%.

Indiana Code defines insulation as any material commonly used by the building industry which is installed for the sole purpose of retarding the passage of heat energy into or out of a building. The Indiana Department of State Revenue (DOR) also considers the following to be insulation: weather stripping, double-pane windows, storm doors, and storm windows.

The insulation project must also meet the following requirements to qualify for the deduction:

- The insulation must be installed in the taxpayer's principal place of residence in Indiana. If the person's principal residence is a rental, they can deduct the insulation costs as long as they are not reimbursed by the landlord.
- The portion of the residence being insulated must have been built at least three years prior to the taxable year the deduction is claimed.
- The deduction must be claimed in the tax year the insulating items were installed.
- The insulating items must either be new or an upgrade. Replacements do not qualify for the deduction unless the replacement is an upgrade.

Improvements that are primarily structural or decorative, such as carpeting, drapes and siding, do not qualify for this deduction, even if they may achieve an insulating effect.

Taxpayers claim the deduction on IT-40, Schedule 2, and IT-40PNR, Schedule C. Each schedule has a dedicated line for the deduction. Taxpayers claiming the deduction are not required to submit additional documentation to the DOR. However, taxpayers are instructed to retain the records of the insulation project. The DOR may require the taxpayer to supply this information at a later date.

Tax Incentive Claims

Table 5 reports the claims history for the home insulation deduction since 2006 and compares it with estimates of home improvement expenditures in Indiana for the same period. From 2006 to 2010 the number of claims and the amount claimed was fairly stable, but has declined significantly since 2010. So, the decline in the deduction did not correspond with the Great Recession, but has occurred after the recession and during the recovery period. In contrast, the Indiana home improvement expenditure series correlates with the recession and recovery period.

The total deductions claimed in 2012 ($26.9 million) resulted in a state revenue loss of about $916,000

Table 5: Home Insulation Deduction Claim History

Tax Year	Number of Claims	% Change of Claims	Claim Amount	% Change in Claim Amount	Indiana Home Improvement Expenditures	% Change in Home Improvement Expenditures
2006	70,542		$49,669,191		$5,362,400,000	
2007	65,553	(7.1)	46,256,562	(6.9)	5,719,300,000	6.2
2008	63,659	(2.9)	45,752,364	(1.1)	5,105,900,000	(12.0)
2009	79,988	25.7	55,952,660	22.3	4,492,500,000	(13.7)
2010	76,132	(4.8)	54,222,486	(3.1)	4,273,500,000	(5.1)
2011	49,011	(35.6)	34,564,311	(36.3)	4,054,500,000	(5.4)
2012	37,413	(23.7)	26,926,543	(22.1)	4,252,800,000	4.7
2013*	41,839		30,054,550		4,451,200,000	4.5

Sources: OFMA income tax return databases. Joint Center for Housing Studies tabulations of the 1995-2011 American Housing Survey, American Community Survey. Expenditure totals for 2007, 2009, and 2011 are estimated by the Joint Center for Housing Studies. Alternate years are imputed by the Office of Fiscal and Management Analysis, Legislative Services Agency. Expenditure totals for 2012 and 2013 were estimated by the Office of Fiscal and Management Analysis based on data from IHS Global Insight.

*The 2013 filer counts and credit amounts are not full-year totals because of filing extensions and suspension of returns for audit.

and a local revenue loss of about $377,000 based on the median LOIT rate.

Table 6 reports the income distribution of the deduction for tax year 2012. Most of the deduction amount claimed is attributable to taxpayers with incomes between $1 and $150,000. About 62% of the deduction amount claimed is attributable to taxpayers with incomes between $25,000 and $100,000. The impact of the deduction on the tax liability of deduction claimants declines substantially as income increases because the deduction is a fixed dollar amount. The tax liability impact ranges from a high of about 7.3% for taxpayers with incomes between $1 and $25,000 to well below 1% for taxpayers with incomes above $100,000.

Effectiveness of Tax Incentive

The link between the home insulation deduction and taxpayers' expenditures on qualified home insulation projects is questionable and appears to be very weak, if at all present. This conclusion is based on the following:

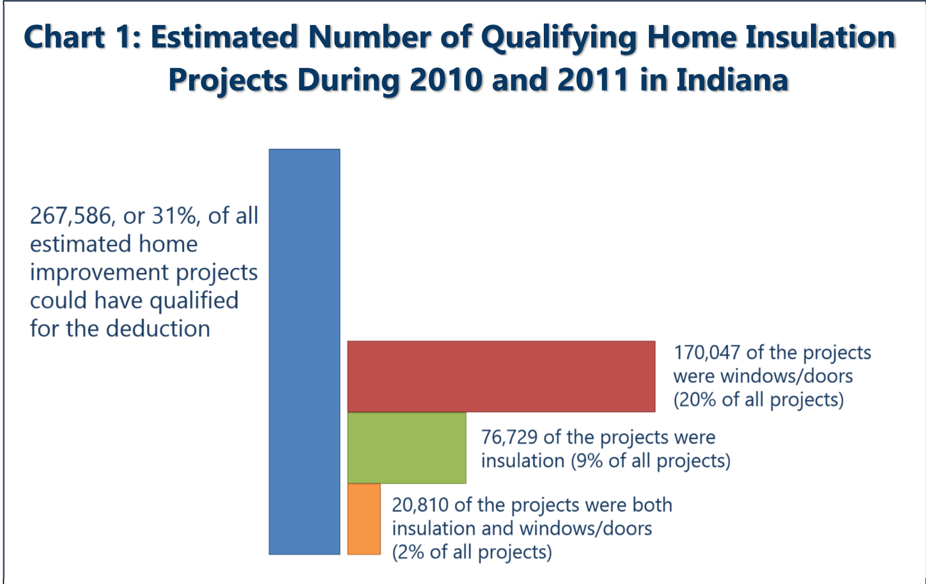
Table 6: Income Distribution of Home Insulation Deduction Claims for Tax Year 2012

Federal Adjusted Gross Income	Total Number of Returns	Number of Deduction Claims	Deduction Amount	Distribution of Deduction Amount	% Change in Claimant Tax Liability
Under $1	100,769	144	$108,389	0.4%	1.39%
$1 Under $25,000	1,316,606	5,679	4,135,072	15.4%	7.32
$25,000 Under $50,000	724,677	8,724	6,067,376	22.5%	2.26
$50,000 Under $75,000	417,978	8,194	5,762,192	21.4%	1.32
$75,000 Under $100,000	264,758	6,325	4,531,022	16.8%	0.94
$100,000 Under $150,000	218,491	5,722	4,191,206	15.6%	0.67
$150,000 Under $200,000	63,205	1,562	1,221,773	4.5%	0.49
$200,000 Under $500,000	55,981	929	789,149	2.9%	0.32
$500,000 or More	14,607	134	120,364	0.4%	0.10

- The reduction in tax liability resulting from the deduction.
- The project cost discount resulting from the deduction.
- The potential spending response of taxpayers to the discount provided by the deduction.
- Research evaluating the effectiveness of the federal energy conservation tax credit.
- Research evaluating the effectiveness of delayed discounts and rebates on consumer purchasing behavior.

Evaluation of Deduction Based on Discount Provided and Taxpayer Response to Discount

There are approximately 1.74 million owner-occupied houses in Indiana.[9] It is estimated that about 856,300 households in Indiana conducted some kind of home improvement project over the two-year period from 2010 to 2011.[10,11] Chart 1 reports an estimate of the home insulation projects undertaken during 2010 and 2011 that could have qualified for the deduction and the distribution of these projects by type of insulation product. It's estimated that almost 268,000 projects were completed during the 2010-2011 period. In contrast, the deduction claims for this two-year period totaled about 125,000, so less than half (47%) of the qualifying projects resulted in a deduction claim. Based on these 2010-2011 project estimates, annual expenditures in Indiana for home insulation projects are estimated to total $310.5 million.



The deductions claimed by taxpayers in 2012 under the home insulation deduction totaled about $26.9 million. Home insulation project expenditures directly related to these deduction claims are estimated to total about $86.8 million. Consequently, taxpayers were able to deduct from taxable income about 31% of the insulation project costs due to the $1,000 deduction limit. Still, the deduction provided only a $1.3 million reduction in tax liability to these taxpayers, which amounts to an average discount of only about 1.49% on the home insulation project costs.

The impact of the deduction on tax liability also suggests that it is an ineffective tool to encourage project spending that would otherwise not have occurred. The income distribution of the deduction claims reported in Table 6 indicates that the tax liability reduction received by about 60% of the taxpayers claiming the deduction was about 1.3% or less.

[9] U.S. Census Bureau (2014). 2008-2012 American Community Survey: Selected Housing Characteristics. Retrieved on July 28, 2014. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_12_5YR_DP04&prodType=table

[10] U.S. Census Bureau (2013). 2011 American Housing Survey: Home Improvement Characteristics – Owner-Occupied Units. May 16, 2013. Retrieved on July 28, 2014. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=AHS_2011_C15OO&prodType=table

[11] Indiana Department of State Revenue (2013). Tax Year 2010 and 2011 Individual Income Tax Returns.

Research by Cameron, estimating the consumer demand response to changes in the price of energy efficiency products, also suggests that the deduction is ineffective.[12] The research suggests that the price elasticity for installation of insulation products could potentially be equal to -0.16, suggesting a 10% decrease in project cost could result in only a 1.6% increase in project spending by taxpayers claiming the deduction. Since the deduction reduces the home insulation project costs by an estimated 1.49% on average, the price elasticity estimate suggests that the deduction may have induced only about $738,000 in additional spending out of total estimated spending of about $310.5 million.

Evaluation of Deduction Based on Research Relating to Comparable Federal Tax Incentives

Findings of evaluations of the federal residential energy conservation tax credits are ambiguous. Survey research suggests that these federal tax credits are not a crucial factor in a taxpayer's decision to make qualifying energy savings expenditures. A survey by the U.S. Energy Information Administration suggests that 88% of the taxpayers claiming the federal tax credit would have made these energy conservation expenditures without receiving the tax credit.[13] Likewise, a survey by Pitts and Wittenbach suggests that a very high percentage of taxpayers claiming the federal tax credit would have made the qualifying energy conservation expenditures without receiving the tax credit.[14]

Econometric studies examining the factors that influence whether a taxpayer makes energy conservation expenditures are generally consistent with the findings of the survey research. Research by Walsh suggests that the federal tax credits have not been critical factors in the level of taxpayer expenditures on qualifying energy conservation projects. Rather, the taxpayer's household income, the climate where the taxpayer lives, heating fuel prices, and home ownership are the decisive factors.[15] In contrast, research by Hassett and Metcalf suggests that the tax credit influences the probability that a taxpayer will make qualifying energy conservation expenditures after controlling for whether the taxpayer's state of residence has a similar tax incentive and for unobserved differences among taxpayers.[16] This research suggests that a subsidy for energy conservation expenditures provided via a tax credit, albeit exhibiting a statistically significant impact, is still not an overwhelming factor in the taxpayer's decision to make energy conservation expenditures.

The research literature examining the effectiveness of tax incentives for spending on energy conservation projects focuses on federal tax credits for this purpose. Nevertheless, this research is relevant to examining the effectiveness of Indiana's home insulation deduction because both the federal tax credits and the home insulation deduction provide similar cost reductions or discounts for similar types of energy conservation projects. The federal Energy Conservation Credit, which began in 1978 and expired in 1985, and the federal Residential Energy-Efficiency (Section 25C) Credit, effective since 2005, are compared in Table 7.[17]

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[12] Cameron, Trudy A. (1985). A Nested Logit Model of Energy Conservation Activity by Owners of Existing Single Family Dwellings. The Review of Economics and Statistics. May 1985.
[13] Office of Technology Assessment. (1992). Building Energy Efficiency. OTA-E-518. May 1992.
[14] Pitts, Robert E. and James L. Wittenbach. (1981). Tax Credits as a Means of Influencing Consumer Behavior. Journal of Consumer Research. December 1981.
[15] Walsh, Michael J. (1989). Energy Tax Credits and Housing Improvement. Energy Economics, vol. 11. No.4. October 1989.
[16] Hassett, Kevin A. and Gilbert E. Metcalf (1995). Energy Tax Credits and Residential Conservation Investment: Evidence from Panel Data. Journal of Public Economics. June 1995.
[17] Crandall-Hollock, Margot L. and Molly F. Sherlock. (2014). Residential Energy Tax Credits: Overview and Analysis. Congressional Research Service. March 18, 2014.

not

Table 7: Comparison of the Federal Energy Conservation Tax Credit and the Section 25C Credit

Attribute	Energy Conservation Credit	Residential Energy-Efficiency (Section 25C) Credit
Calculation of Credit	15% of first $2,000 in qualifying expenditures, including installation costs.	10% of Qualifying Energy Efficiency Improvements + Qualifying Energy Property
Types of Qualifying Property	Energy Conservation Property: Insulation, storm windows, storm doors, caulking, weather-stripping, and certain other items such as automatic thermostats.	Energy-efficiency Improvements: Insulation, windows, doors, qualifying metal roof, and asphalt roof with cooling granules Energy Property and Associated Caps: (1) Electric heat pump; central air conditioner; Natural gas, propane, or oil water heater; biomass stove: $300 (2) Natural gas, propane, or oil furnace or hot water boiler: $150 (3) Advanced main air circulating fan: $50
Includes Labor Costs	Yes	No
Credit Cap	$300 (lifetime)	$200 for windows (lifetime) $500 total (lifetime)
Effective Date ***Expiration Date***	January 1, 1978 December 31, 1985	January 1, 2005 December 31, 2013

Source: Internal Revenue Service.

Table 8 illustrates the discounts from the federal credit and the home insulation deduction on typical insulation projects. The discount provided for a home insulation project by the Section 25C federal tax credit and the home insulation deduction are substantially different. For all but one hypothetical project illustrated below, the discount is less than 5% of the total cost, with only one project receiving a larger discount of 10% from the federal tax credit.

Table 8: Insulation Project Savings from State and Federal Energy-Efficiency Tax Incentives

Item	Professionally Installed Insulation		Do-It-Yourself Insulation and Windows		Professionally Installed Insulation and Windows	
	State/Local	Federal	State/Local	Federal	State/Local	Federal
Material	$600.80	$600.80	$1,745.00	$1,745.00	$2,022.40	$2,022.40
Labor	901.20	901.20	0.00	0.00	3,033.60	3,033.60
Total Cost	**$1,502.00**	**$1,502.00**	**$1,745.00**	**$1,745.00**	**$5,056.00**	**$5,056.00**
Tax Savings	(48.00)	(60.08)	(48.00)	(174.50)	(48.00)	(202.24)
Final Cost	**$1,454.00**	**$1,441.92**	**$1,697.00**	**$1,570.50**	**$5,008.00**	**$4,853.76**
% Discount	**3.2%**	**4.0%**	**2.8%**	**10%**	**0.9%**	**4.0%**

Given the similar discounts that could be derived from the federal tax credit and the home insulation deduction we apply the evaluative research on the federal credits to the deduction. Generally, the research literature outlined above relating to the federal credits suggests that energy conservation tax incentives of the magnitude of the home insulation deduction fail to succeed in encouraging additional energy conservation expenditures. The discount provided by the home insulation deduction simply may be too small to motivate any widespread energy conservation project spending by taxpayers. It's also likely that taxpayers are responding to other market forces, such as energy costs, when making energy conservation expenditures. Potentially, taxpayers are claiming the deduction though it has had little impact on their decision to make energy conservation expenditures. This means that taxpayers who would have made these expenditures in the absence of the deduction receive a windfall gain from the deduction.

Evaluation of Deduction Based on Consumer Response to Discounts and Rebates

Potentially, taxpayers could be responding favorably to the home insulation deduction, and it could be influencing taxpayer purchasing behavior, but taxpayers ultimately fail to claim the deduction months later on the individual income tax return. Research on the consumer response to delayed discounts suggests that the deduction could potentially influence taxpayer behavior at the time insulation or other energy conservation products are purchased. However, the taxpayer fails to claim the deduction since the savings due to the deduction are small, the time lag between the purchase and claiming the deduction on the tax return is considerable, and the taxpayer must make an effort to claim the deduction on the tax return. This phenomenon is called breakage.

The deduction works exactly like a mail-in rebate with a delay in receiving the discount of up to 16 months. Research on rebates suggests that the longer delay between the time of purchase and redemption of the rebate, the more likely breakage will occur.[18] There is evidence that breakage occurs with the federal tax credits. Recall, the EIA survey found that 85% of the households making qualified energy conservation expenditures failed to claim the federal tax credit.[19] A literature review by Edwards reported the estimates of rebate redemption found in academic articles and press accounts range from 2% to 40%, depending on the product category.[20] The research suggests that while the value of the delayed incentive influences the consumer's likelihood of making the purchase, it does not necessarily increase the likelihood the incentive will be claimed.

Economic Impact of Tax Incentive

We employed the IMPLAN Model to examine the potential economic impact of the home insulation deduction. [See Appendix 10 for a detailed explanation of the IMPLAN Model and its impact estimates.] Generally, an economic impact analysis measures the effect of some activity on the economy of a specified geographic area like a county, state, or region. The activity could result from a public policy change like a tax incentive. We employ the IMPLAN Model to measure the economic impact of the deduction on the Indiana economy, specifically the employment, labor income, and output impacts. The economic impact analysis does not examine the effectiveness of a tax incentive like the home insulation deduction. That is, it doesn't assess whether the deduction has encouraged additional expenditures on home insulation projects. Rather, the economic impact

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[18] Pechmann, Cornelia and Tim Silk (2013). Policy and Research Related to Consumer Rebates: A Comprehensive Review. Journal of Public Policy & Marketing Vol. 32. Fall 2013.

[19] Office of Technology Assessment. (1992). Building Energy Efficiency. OTA-E-518. May 1992.

[20] Edwards, Matthew (2007). The Law, Marketing and Behavioral Economics of Consumer Rebates. Stanford Journal of Law, Business & Finance. Vol. 12:2. Spring 2007.

analysis takes an estimate of the activity that's been induced by the tax incentive and demonstrates how that activity could flow through the different sectors of the Indiana economy.

The economic impact analysis relies on the following assumptions:

(1) The geographic region of analysis is the state of Indiana.
(2) The estimated total spending on insulation projects associated with deduction claims is based on home improvement project activity estimated by the U.S. Census Bureau and the actual deduction claims from tax year 2012.[21]
(3) The projects are classified as do-it-yourself and professional installation using the home improvement project estimates by the U.S. Census Bureau.[22] The professional installation expenditures are separated into material and labor based on industry standards.
(4) Consumers will purchase insulation products from local retail or wholesale suppliers and use local labor for the installation of the products.
(5) All estimates are derived using the IMPLAN regional input-output model. The estimates demonstrate the extent that the retailer's or wholesaler's demand for insulating materials will likely be fulfilled by Indiana suppliers.
(6) The impact of the production of the insulation materials is included in the direct impact of the insulation projects. In most cases, the production of goods for a wholesaler would be included in the supply chain impact. Instead, we include the wholesale activity in the direct impact to guarantee the retail/wholesale stock purchases will be associated with the proper production industry. The supply chain impact contains only the impact of the necessary intermediate goods and services to support the producers, wholesalers, and labor involved in product installation.

The economic impact of home insulation spending that we estimate was actually induced by the deduction is discussed in the next section of the report.

Estimated Economic Impact

The estimated economic impact of the home insulation deduction assumes only a small portion of the total annual spending on home insulation projects is induced by the deduction. The estimated annual total spending on projects that could qualify for the deduction is $310.5 million for an estimated 134,000 projects. This total includes projects and spending associated with deduction claims and projects and spending that could have qualified for the deduction but did not result in deduction claims.

Table 9 reports the economic impact of additional home insulation project spending induced by the home insulation deduction. The induced activity is estimated based on the discount from the

Table 9: Economic Impact of Additional Home Insulation Project Expenditures Induced by the Deduction

Activity		$737,761	
First round of spending leaving the state		$179,495	
Economic Impact from	**Employment**	**Labor Income**	**Output**
the activity directly	3.3	$172,950	$516,679
inter-industry spending through the supply chain	1.4	64,316	185,117
local spending of wages & salaries	1.5	56,962	172,861
Total Impact	**6.2**	**$294,228**	**$874,657**

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[21] U.S. Census Bureau (2014). 2011 American Housing Survey: Home Improvement Costs – Owner-Occupied Units. Retrieved on July 28, 2014. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=AHS_2011_C15OO&prodType=table

[22] Ibid.

deduction and an estimate of the consumer spending response to the deduction. On average, the discount on home insulation project costs to taxpayers claiming the deduction is estimated at 1.49%. Research by Cameron suggests that the price elasticity for home insulation projects could potentially be equal to -0.16.[23] These measures suggest that the deduction may have induced only about $738,000 in additional spending out of the total estimated spending of about $310.5 million.

It's estimated that the induced project spending would support only about 6 jobs, generate only about $294,000 in additional labor income, and $875,000 in additional economic output. The additional labor income could potentially result in additional state and local income tax revenue totaling about $12,000 to $13,000. In comparison, the deduction cost the state and local governments approximately $1.29 million in lost income tax revenue.

Solar-Powered Roof Vent/Fan Installation Deduction

(IC 6-3-2-5.3)

- Enacted in 2009; effective in 2009
- Deduction equals up to 50% of the total installation cost up to $1,000.

Background

The solar-powered roof vent/fan installation deduction was established to provide taxpayers with an incentive to purchase and install solar-powered roof vents or fans. The deduction equals 50% of the total installation cost, both materials and labor. The maximum deduction is $1,000. The deduction was enacted in 2009 and went into effect in tax year 2009.

The deduction reduces the taxpayer's Indiana adjusted gross income before the application of the income tax rate. The tax savings from the deduction equals the deduction amount multiplied by the tax

Table 10: Solar-Powered Roof Vent or Fan Deduction Claim History

Tax Year	Number of Claims	% Change of Claims	Claim Amount	% Change in Claim Amount	Indiana Home Improvement Expenditures	% Change in Home Improvement Expenditures
2009	195		$102,771		$4,492,500,000	
2010	249	27.7	137,955	34.2	4,273,478,669	(5.1)
2011	216	(13.3)	126,934	(8.0)	4,054,500,000	(5.4)
2012	277	28.2	152,718	20.3	4,252,833,674	4.7
2013*	532	92.1	337,590	121.1	4,451,200,000	4.5

Sources: OFMA income tax return databases. Joint Center for Housing Studies tabulations of the 1995-2011 American Housing Survey, American Community Survey. Expenditure totals for 2007, 2009, and 2011 are estimated by the Joint Center for Housing Studies. Alternate years are imputed by the Office of Fiscal and Management Analysis, Legislative Services Agency. Expenditure totals for 2012 and 2013 were estimated by the Office of Fiscal and Management Analysis based on data from IHS Global Insight.

*The 2013 filer counts and credit amounts are not full-year totals because of filing extensions and suspension of returns for audit.

[23] Cameron, Trudy A. (1985). A Nested Logit Model of Energy Conservation Activity by Owners of Existing Single Family Dwellings. The Review of Economics and Statistics. May 1985.

rate. Consequently, the maximum $1,000 deduction will reduce the state income tax liability by $34, and the local option income tax (LOIT) liability by $14 based on the median LOIT rate of 1.4%.

A solar-powered roof vent or fan is powered by a solar panel attached to the vent or fan instead of a conventional AC power line. Powered attic vents or fans are installed to remove hot air from attics during the summer. They are promoted to increase shingle life, decrease attic temperatures, and lower summer cooling costs.

An Indiana taxpayer can claim the deduction if he or she installs a solar-powered roof vent or fan on a building the taxpayer owns or leases. It must be claimed in the year the vent or fan is installed. The deduction may be claimed on Schedule 2 of the IT-40 tax form. The form does not have a dedicated line.

Taxpayers are instructed to enter a specific code, found in the instructions, along with the deduction amount in the 'other deductions' section. Taxpayers claiming the credit are not required to submit additional documentation to the Department of State Revenue (DOR). Taxpayers are instructed to retain the records of the installation. However, the DOR may require a taxpayer to provide proof of the installation costs and a list of the people who supplied the labor or materials.

Tax Incentive Claims

Table 10 reports the claims history for the solar-powered roof vent/fan installation deduction since 2009 when the deduction went into effect. Table 10 compares the deduction claims to estimates of home improvement expenditures in Indiana for the same period. Because the deduction started in 2009, it is likely still maturing. While the number and amount of deduction claims is still extremely small, usage has grown at a significant rate during the time the deduction has been in place.

The total deductions claimed in 2012 ($152,718) resulted in a state revenue loss of only about $5,192 and a local revenue loss of about $2,138 based on the median LOIT rate.

Table 11 reports the income distribution of the deduction for tax year 2012. The bulk of the deduction amount claimed is attributable to taxpayers with incomes between $1 and $150,000. Roughly 59% of the deduction amount claimed is attributable to taxpayers with incomes between $25,000 and $100,000. Because the deduction is a flat dollar amount, the percentage impact on the tax liability of deduction claimants falls precipitously as income increases. The tax liability impact ranges from a high of about 6% for taxpayers with incomes between $1 and $25,000 to

Table 11: Income Distribution of Solar-Powered Roof Vent or Fan Deduction Claims for Tax Year 2012

Federal Adjusted Gross Income	Total Number of Returns	Number of Deduction Claims	Deduction Amount	Distribution of Deduction Amount	% Change in Claimant Tax Liability
Under $1	100,769	1	$204	0.1%	0.00%
$1 Under $25,000	1,316,606	50	25,812	16.9%	6.01
$25,000 Under $50,000	724,677	56	34,829	22.8%	2.10
$50,000 Under $75,000	417,978	51	27,796	18.2%	1.02
$75,000 Under $100,000	264,758	50	27,323	17.9%	0.73
$100,000 Under $150,000	218,491	41	24,209	15.9%	0.55
$150,000 Under $200,000	63,205	15	6,566	4.3%	0.27
$200,000 Under $500,000	55,981	12	5,604	3.7%	0.20
$500,000 or More	14,607	1	375	0.2%	0.06

well below 1% for taxpayers with incomes above $100,000.

Effectiveness of Tax Incentive

The link between the solar-powered roof vent/fan deduction and taxpayers' expenditures on the purchase and installation of these products is questionable and appears to be very weak, if at all present. This conclusion is based on the following:

- The reduction in tax liability resulting from the deduction.
- The project cost discount resulting from the deduction.
- The potential spending response of taxpayers to the discount provided by the deduction.
- Research evaluating the effectiveness of the federal energy conservation tax credit.
- Research evaluating the effectiveness of delayed discounts and rebates on consumer purchasing behavior.

Evaluation of Deduction Based on Discount Provided and Taxpayer Response to Discount

There are approximately 1.74 million owner-occupied houses in Indiana.[24] Of the total households, an estimated 856,300 households conducted a home improvement project in 2010 and 2011.[25] No estimates or data are available relating to the number of attic ventilation projects completed by homeowners. The closest proxy available is roofing projects. Indiana residents completed an estimated 195,000 roofing projects during 2010 and 2011.[26] The number of solar-powered vent/fan installation deductions claimed in 2010 and 2011 totaled 465, which is less than 0.3% of the number of roofing projects completed during that two-year period. Thus, the deduction appears to be ineffective based solely on annual usage as compared to project activity occurring generally throughout the Indiana economy.

The impact of the deduction on tax liability and project cost also suggests that it is an ineffective tool to encourage project spending that would otherwise not occur. The income distribution of the deduction claims reported in Table 11 indicates that the tax liability reduction received by about 60% of the taxpayers claiming the deduction was 1% or less. What's more, the cost discount resulting from the deduction does not equal 50% of the qualifying project cost. Rather, the deduction reduces the taxpayer's Indiana adjusted gross income, so the discount provided by the deduction equals the deduction amount multiplied by the tax rate. The scenario in Table 12 shows that the deduction could potentially reduce the taxpayer's project cost by only 2.33%.

Table 12: Taxpayer Discount Scenario – Solar-Powered Roof Vent/Fan Installation Deduction

Item	Tax Incentive
Solar Vent Fan Cost	$600
Installation Cost	300
Total Cost	**$900**
Deduction Amount (50% of Total Cost)	(450)
Indiana State and Local Tax Savings	**($21)**
Total Projected Cost After Savings	**$879**
Discount %	**2.33%**

[24] U.S. Census Bureau (2014). 2008-2012 American Community Survey: Selected Housing Characteristics. Retrieved on July 28, 2014. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_12_5YR_DP04&prodType=table.

[25] U.S. Census Bureau (2013). 2011 American Housing Survey: Home Improvement Characteristics – Owner-Occupied Units. May 16, 2013. Retrieved on July 28, 2014. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=AHS_2011_C15OO&prodType=table. OFMA income tax databases. Estimate derived from Indiana tax data and information from the 2011 American Housing Survey.

[26] U.S. Census Bureau (2013). 2011 American Housing Survey: Home Improvement Characteristics – Owner-Occupied Units. May 16, 2013. Retrieved on July 28, 2014. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=AHS_2011_C15OO&prodType=table.

Research by Cameron estimating the consumer demand response to changes in the price of energy efficiency products also suggests that the deduction is ineffective.[27] The research suggests that the price elasticity for installation of solar-powered roof vents or fans could potentially be equal to -0.16, suggesting a 10% decrease in project cost could result in only a 1.6% increase in project spending by taxpayers claiming the deduction. Assuming the 2.33% project cost discount due to the deduction and assuming that the total deduction claims during 2012 ($152,718) were 50% of the total expenditures associated with the deduction, the price elasticity estimate suggests that the amount of additional spending induced by the deduction was insignificant.

Evaluation of Deduction Based on Research Relating to Comparable Federal Tax Incentives

Like the home insulation deduction, the research evaluating the effectiveness of the federal residential energy efficiency credit is also applicable to the solar roof vent/fan installation deduction. A detailed discussion of this research is contained in the section of this report concerning the home insulation deduction. The solar roof vent/fan installation deduction, like the home insulation deduction, was established to induce additional spending on residential energy efficiency projects. Both deductions target the same population using similar tax incentives to impact taxpayer behavior. Based on this research, it is doubtful that the solar roof vent/fan installation deduction is effective. At best, the research suggests that if the deduction encourages additional project spending, the impact is small compared to the impact of other factors such as household income, climate where the home is located, and heating fuel prices.

Evaluation of Deduction Based on Consumer Response to Discounts and Rebates

Like the home insulation deduction, the research evaluating the effectiveness of mail-in rebates and delayed discounts is also pertinent to the solar roof vent/fan installation deduction. A detailed discussion of this research is contained in the section of this report concerning the home insulation deduction. The deduction works exactly like a mail-in rebate with a delay in receiving the discount for up to 16 months once the taxpayer files his or her tax return.

Research on the consumer response to delayed discounts suggests that the deduction could potentially influence taxpayer behavior at the time of purchasing and installing a solar roof vent or fan. However, the taxpayer may fail to claim the deduction since the savings due to the deduction are small, the time lag between the purchase and claiming the deduction on the tax return is considerable, and the taxpayer must make an effort to claim the deduction on the tax return. In addition, the actual amount of project savings is less than the face value of the deduction. This may cause dissatisfaction once the taxpayer computes his or her discount. These factors may explain the extremely small number of claims for this deduction since it began in 2009.

Economic Impact of Tax Incentive

We employed the IMPLAN Model to examine the potential impact of the solar-powered roof vent/fan installation deduction on the Indiana economy, specifically the employment, labor income, and output impacts. [See Appendix 10 for a detailed explanation of the IMPLAN Model and its impact estimates.] This impact analysis does not examine whether the deduction has encouraged additional

[27] Cameron, Trudy A. (1985). A Nested Logit Model of Energy Conservation Activity by Owners of Existing Single-Family Dwellings. The Review of Economics and Statistics. May 1985.

expenditures on solar-powered roof vents or fans, but takes an estimate of expenditures induced by the deduction and demonstrates how that activity could flow through the different sectors of the Indiana economy.

The economic impact analysis on this deduction relies on many of the same assumptions outlined previously for the analysis of the home insulation deduction. In this analysis, we evaluate the impact of the total spending on solar-powered roof vent or fan projects associated with actual claims of the solar-powered roof vent/fan installation deduction in tax year 2012.[28] In addition, we classify projects as do-it-yourself and professional installation using home improvement project estimates by the U.S. Census Bureau.[29] The professional installation expenditures are separated into parts and labor based on a Florida Solar Energy Center case study.[30]

The economic impact of spending on solar-powered roof vent/fan projects that we estimate was actually induced by the deduction is discussed in the next section of the report.

Estimated Economic Impact

The estimated economic impact of the solar-powered roof vent/fan installation deduction assumes only a small portion of the total annual spending on these roof vent or fan projects is induced by the deduction. Table 13 summarizes the economic impact estimate. The estimate assumes that consumers were already going to install a less expensive AC-powered roof vent or fan and the deduction encouraged them to purchase a more expensive solar-powered model. The economic impact estimate is based on the difference between the cost of installing a solar-powered roof vent or fan and the cost of installing an AC-powered roof vent or fan.

The total solar-powered roof vent/fan installation costs was estimated to be about $305,400 based on the tax year 2012 deduction claims. The estimated installation costs for AC-powered roof vent or fan projects costs was also based on the 2012 deduction claims, except the material portion of the project cost was reduced because AC-powered roof vents or fans are less expensive. A price comparison found that AC-powered roof vents or fans were on average 60% cheaper than the solar-powered units. The cost for the consumers to install AC-powered roof vents or fans was estimated at $176,670. Consequently, the economic impact estimate of the deduction was based on the cost difference of $128,730.

It's estimated this induced project spending would have virtually no impact on employment and would

Table 13: Economic Impact of Upgrading from an AC-Powered Fan to a Solar-Powered Fan Due to the Deduction

Activity		$128,730	
First round of spending leaving the state		$84,086	
Economic Impact from	**Employment**	**Labor Income**	**Output**
the activity directly	0.2	$11,301	$38,504
inter-industry spending through the supply chain	0.1	$3,474	$10,263
local spending of wages & salaries	0.1	$3,583	$10,873
Total Impact	**0.4**	**$18,358**	**$59,640**

[28] OFMA income tax return database, 2012.

[29] U.S. Census Bureau (2014). 2011 American Housing Survey: Home Improvement Costs – Owner-Occupied Units. Retrieved on July 28, 2014. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=AHS_2011_C15OO&prodType=table

[30] Parker, Danny S. and John R. Sherwin (2000). Performance Assessment of Photovoltaic Attic Ventilator Fans. FSEC-PG-171-00. May 2000.

result in only about $18,000 in additional labor income and potentially $800 in additional state and local income tax revenue. What's more, the induced project spending is estimated to have resulted in only about $60,000 in additional economic output. This is compared to the revenue loss from the deduction in 2012 of about $152,718.

Estimating the economic impact based on the cost difference between the solar-powered and AC-powered roof vent or fan is plausible for two reasons. First, survey research evaluating the effectiveness of the federal residential energy tax credit indicated that most consumers were planning to make project expenditures without receiving the federal tax credit.[31] This suggests that the federal tax credit, at best, had only a marginal impact. So, potentially the solar-powered roof vent/fan deduction has only a marginal impact since consumers were already committed to install some type of roof vent or fan. Second, Gallagher and Muehlegger noted that for an income tax incentive to be effective, it must be known, understood, and applied for in the future.[32] In the case of the solar-powered roof vent/fan installation deduction, consumers may have overestimated the discount provided by the deduction when purchasing a standard AC-powered roof vent or fan.

The deduction may have induced these consumers to upgrade to a more expensive solar-powered unit. The average AC-powered roof vent or fan costs about $120, while a solar-powered unit costs about $300. The deduction allows a taxpayer to reduce his or her taxable income by 50% of the cost of the roof vent or fan, with the tax liability reduction equal to only the deduction amount multiplied by the tax rate. The deduction does not reduce the taxpayer's tax liability by 50% of the cost of the roof vent or fan. However, it's possible that taxpayers thought the reduction in tax liability from the deduction would be $150 (50% of the roof vent or fan cost) instead of $7.20, or 2.33% of the cost (the actual discount provided by the deduction as shown in Table 12).[33] This misunderstanding may have encouraged taxpayers to upgrade from the AC-powered roof vent or fan to the solar-powered unit. Such a misunderstanding is plausible. The Internal Revenue Service reports that the complexity of the tax code results in taxpayers not fully understanding many nuances of the individual income tax and, as a result, making inadvertent errors.[34] In addition, survey research on the federal residential energy credit by Pitts and Wittenbach indicated that only 37% of taxpayers understood how the federal residential energy tax credit worked.[35]

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[31] Office of Technology Assessment. (1992). Building Energy Efficiency. OTA-E-518. May 1992.

[32] Gallagher, Kelly S. and Erich Muehlegger. (2008). Giving Green to Get Green: Incentives and Consumer Adoption of Hybrid Vehicle Technology. Harvard University Faculty Working Paper. February 2008.

[33] The $7.20 tax savings would be 50% of the solar-powered roof vent or fan cost of $300 multiplied by the combined state and local tax rate of 4.8%.

[34] Internal Revenue Service. (2012). National Taxpayer Advocate 2012 Annual Report to Congress Volume 1. Publication 2104. December 31, 2012.

[35] Pitts, Robert E. and James L. Wittenbach. (1981). Tax Credits as a Means of Influencing Consumer Behavior. Journal of Consumer Research. December 1981.

Indiana Partnership Long-Term Care Insurance Premiums Deduction

(IC 6-3-1-3.5)

- Enacted in 1999; effective in 2000
- Deduction reduces Indiana adjusted gross income by premiums paid.

Background

The Indiana Partnership Long-Term Care Program was created to help elderly taxpayers afford long-term care (e.g., in-home care, adult day care, assisted living or nursing home care, case management services). The deduction equals the premiums paid during the taxable year by the taxpayer for a partnership program long-term care insurance policy for the taxpayer or the taxpayer's spouse, or both. The deduction was enacted in 1999 and went into effect in 2000.

The deduction reduces the taxpayer's Indiana adjusted gross income before the application of the income tax rate. The cost of a partnership policy depends on the policyholder's age and health status, the insurance company offering the policy, and the type of policy benefits. The average premium of a policy is $7,998 for males and females aged 55 to 75. The tax savings from the deduction equals the deduction amount multiplied by the tax rate. Based on the average premium, the deduction will reduce the state income tax liability by about $279 and the local option income tax (LOIT) liability by about $112 based on the median LOIT rate of 1.4%. Taxpayers claim the deduction on IT-40, Schedules 1 and 2, under Other Deductions, code 608.

Long-term care may cost upwards of $30,000 to $65,000 per year, and many people lack sufficient assets to fund that care.[36] Therefore, they generally rely on Medicaid, the second-largest program in most states' budgets after elementary and secondary education. The tax deduction intends to encourage individuals to purchase long-term care insurance and thereby reduce their future dependence on Medicaid, of which one third is already allocated to long-term care expenditures.

From the consumer's perspective, long-term care insurance may be beneficial because it could help the consumer avoid high out-of-pocket expenses for long-term care, poor quality of service and asset depletion. Strict criteria must be met for elderly citizens to qualify for payment of long-term care services under Medicare, which typically provides limited coverage for about three months, or Medicaid, whose providers are sometimes purported to offer lesser quality care than that financed through private pay and long-term care insurance. Moreover, Medicaid stipulates a "spend-down" policy, whereby individuals seeking assistance must spend down their assets to $1,500 if they are single and $2,250 if they are married. Additionally, about 21% of long-term care financing is out of pocket (Goda, 2011).[37]

The Partnership Program is a partnership between the state of Indiana and private insurance programs. California, Connecticut, and New York also offer long-term care partnership insurance. What's more, a majority of the states have reciprocity policies, allowing them to honor

[36] Insurance by Allied Brokers. http://www.alliedbrokers.com/retirement_planning.html
[37] Goda, Gopi Shah. (2011). The Impact of State Tax Subsidies for Private Long-Term Care Insurance on Coverage and Medicaid Expenditures. Journal of Public Economics August 2011.

partnership long-term care insurance policies from other states and making it more convenient for policyholders to easily transfer their insurance policy benefits when they move.[38] The Partnership Program policies differ from traditional long-term care policies in that they provide additional protection for those who decide to apply to Medicaid upon exhaustion of their policy benefits. This means that Medicaid behaves as a secondary payer, where once an individual becomes Medicaid-eligible, the Partnership Program policy pays benefits first and Medicaid pays the remainder. For example, if the average daily cost of a nursing home bed is $200 and the partnership program policy pays out $150 per day, Medicaid pays the difference of $50. Of course, individuals may instead need to pay the difference out of pocket. To date, only 0.1% of all active Partnership Program policyholders have exhausted their benefits and applied to Medicaid.

The Partnership Program lifts the strict Medicaid guidelines through "Medicaid Asset Protection," which relaxes the requirement that Indiana residents spend down their assets. Instead, partnership policies protect the assets of their policyholders and allow them financial flexibility in the final disposition of their assets, including bequeathal to their heirs. Medicaid asset protection works in two ways: (1) if individuals purchase a partnership policy with less than the state-mandated dollar amount in benefits, each dollar of their assets is protected for each dollar of partnership policy benefits paid out and (2) if individuals purchase a partnership policy with at least the state-mandated dollar amount and a 5% compound inflation factor, their total assets are protected. The mandated amount for 2015 is $321,000 and will increase by about 5% annually. The Partnership Program offers additional benefits, including inflation protection against rising insurance premium costs, which reveal the higher quality of partnership policies over traditional long-term care policies not sold under the Partnership Program.

Tax Incentive Claims

Table 14 reports the Long-Term Care Partnership Program deduction claim history since 2006 and compares these claims to the annual partnership

Table 14 Long-Term Care Partnership Program Deduction Claim History

Tax Year	Number of Claims	% Change of Claims	Claim Amount	% Change in Claim Amount	Active Policies	% Change in Active Policies
2006	10,612		$25,947,594		32,616	
2007	11,588	9.2	28,885,466	11.3	34,825	6.8
2008	11,799	1.8	30,012,658	3.9	36,522	4.9
2009	11,794	0.0	31,417,120	4.7	37,310	2.2
2010	12,378	5.0	34,191,140	8.8	38,954	4.4
2011	13,488	9.0	36,783,234	7.6	40,652	4.4
2012	14,341	6.3	39,909,704	8.5	41,334	1.7
2013**	14,367		40,489,027			

Sources: OFMA income tax return databases. Indiana Family and Social Services Administration, Long-term Care Partnership Program, Quarterly Statistics Reports, http://www.in.gov/iltcp/2335.htm.

*The 2013 filer counts and credit amounts are not full-year totals because of filing extensions and suspension of returns for audit.
**Policies in force during fourth quarter of each year.
*U.S. Census Bureau, American Community Survey.
**The 2013 filer counts and credit amounts are not full-year totals because of filing extensions and suspension of returns for audit.

[38] American Association for Long-Term Care Insurance. Long-term Care Insurance Partnership Plans. http://www.aaltci.org/long-term-care-insurance/learning-center/long-term-care-insurance-partnership-plans.php#approved

program policies in force. The number of claims generally rose over the study period. The relatively high growth rate just preceding the recession gave way to a period of very low growth in 2008 and 2009. Since 2009, however, deduction claims have grown significantly by an annual average rate of almost 7%. As of the fourth quarter of 2012, over 41,000 policies are active, but only 35% of total policyholders claimed the long-term care deduction during 2012. We discuss potential reasons for the relatively low number of claims below. It's interesting that the growth in deduction claims since 2009 appears to have outstripped the growth in active policies. This suggests that more policyholders, possibly new and existing, are learning about and claiming the deduction.

Table 15 reports the income distribution of the deduction for tax year 2012. The deduction claims are distributed over a very broad range of incomes, with an average of 2,463 claims per income tier. The bulk of the deductions claimed are attributable to taxpayers with incomes ranging from $50,000 to $150,000 (54%). Almost 16% of the deductions claimed are attributable to taxpayers with incomes of $150,000 or above. Surprisingly, however, about 30% of the deductions claimed are attributable to low and moderate incomes of less than $50,000. This concentration of deduction claims in low to moderate income ranges is probably because almost two thirds of the partnership program policyholders are above the age of 65. Taxpayers in these income ranges also benefit from the largest reduction in tax liability due to the deduction ranging from about 10% to almost 30%. For taxpayers with incomes above $50,000, the tax liability impact drops significantly to about 6% or well below that level.

Effectiveness of Tax Incentive

The impact of this tax deduction is somewhat unclear. While much of the evidence suggests that the tax deduction does not encourage purchases of Partnership Program policies, some evidence suggests that the deduction may indeed encourage purchases of these policies.

One study estimating the spending response by purchasers of long term care insurance to changes in premiums suggests that a deduction reducing the price of long term care insurance could encourage additional spending on the product. However, the following evidence points to a tenuous link between policy purchases and the deduction:

- There exists weak demand for long-term care insurance to begin with and some research suggests a weak response to tax incentives by purchasers of long-term care insurance.
- Partnership insurance programs tend to attract higher-income individuals who may very well have purchased the insurance anyway.
- It appears that a significant percentage of purchasers are unaware of the tax deductibility

Table 15: Income Distribution of Long-Term Care Deduction Claims for Tax Year 2012

Federal Adjusted Gross Income	Total Number of Returns	Number of Deduction Claims	Deduction Amount	Distribution of Deduction Amount	% Change in Claimant Tax Liability
Under $1	100,769	100	$321,207	0.8%	22.7%
$1 Under $25,000	1,316,606	2,069	5,239,623	13.1%	29.0%
$25,000 Under $50,000	724,677	2,560	6,512,813	16.3%	10.6%
$50,000 Under $75,000	417,978	2,783	7,213,255	18.1%	6.1%
$75,000 Under $100,000	264,758	2,429	7,001,944	17.5%	4.6%
$100,000 Under $150,000	218,491	2,473	7,353,256	18.4%	3.0%
$150,000 Under $200,000	63,205	925	2,819,802	7.1%	2.0%
$200,000 Under $500,000	55,981	829	2,704,104	6.8%	1.2%
$500,000 or More	14,607	173	743,700	1.9%	0.5%

Source: OFMA income tax return databases.

of the premiums on Partnership Program policies.

- The tax savings from the deduction for many taxpayers is minimal.
- It is difficult to definitively sort out the factors that may have influenced annual purchases of Partnership Program policies since 1998, including the premium deduction, total asset protection coverage, market factors, and the economic cycle.

Evaluation of Deduction Based on Taxpayer Demand for Policies

Approximately 916,000 elderly individuals (population aged 65 and over) currently live in Indiana. However, only 53,000 long-term care partnership policies have been purchased to date, and about 41,000 policies are currently active. At first glance, partnership programs do not appear to significantly alleviate the burden on Medicaid, as only 4.5% of the elderly population has purchased policies and only 4% of that population has received some amount of benefits thus far. Moreover, the tax deduction, which is aimed at increasing the number of policy purchases, has been utilized modestly. Only 35% of total active policyholders claimed the long-term care deduction on policy premiums during 2012. While this is not an insignificant share, still 65% of the policyholders fail to claim the rather generous deduction with an impact on state and local tax liability totaling $391 based on the average premium cost. This brings into question the effectiveness of the tax incentive. Based on the sheer number of deduction claims, the tax incentive does not appear to be effective. Three reasons point to the weak demand for partnership program long-term care insurance. One is that policies are still expensive regardless of inflation protection. Medicaid asset protection does not necessarily drive individuals to purchase long-term care insurance, as buyers typically possess modest levels of financial wealth to begin with. If they do purchase insurance, some policyholders may not exhaust their insurance benefits and easier access to Medicaid may not be an incentive. Another is that there may exist potential substitutes for long-term care insurance such as financial support and/or home care provided by family members. Finally, especially lower-income people may not prefer to purchase insurance due to the alternative presence of Medicaid. Brown et al. (2007) find that Medicaid "crowds out" the demand for long-term care insurance for wealth groups below the 60th percentile, since those groups are more likely to meet the strict guidelines of Medicaid. [39]

Consumer Response to Partnership Program Tax Incentives

Two primary demographic factors that influence the decision to purchase long-term care insurance are personal wealth and gender. Specifically, high-wealth individuals are more likely to purchase policies. A Connecticut study finds that almost 50% of all partnership purchasers possessed assets over $350,000, while 17% possessed assets less than $100,000. Contrarily, McCall (1997)[40] finds that purchasers of policies from the California Partnership Program tend to have lower levels of income than do purchasers of nonpartnership long-term care insurance policies. Additionally, the higher likelihood of women to need nursing home care makes them more prone to purchase partnership policies. Women have greater willingness to pay for partnership policies than for traditional policies at all wealth percentiles from 40-90%[41].

It may be that people with larger assets find partnership policies more beneficial for protecting

[39] Brown, Jeffrey R., Norma B. Coe, and Amy Finkelstein. (2007) Medicaid crowd-out of private long-term care insurance demand: Evidence from the health and retirement survey. Tax Policy and the Economy, Volume 21. MIT Press.
[40] McCall, Nelda. (1997). How Partnership Purchasers Differ from Purchases of Other Long-Term Care Insurance in California. Health Policy Research Series Discussion Paper #97-5 (San Francisco, Cal.: Laguna Research Associates, 1997).
[41] Sun, Wei, and Anthony Webb. (2013). *Can Incentives for Long-Term Care Insurance Reduce Medicaid Spending?* No. ib2013-6.

their assets from Medicaid's spend-down policy. Regardless of wealth, some individuals may be less risk averse than those who purchase insurance to cushion themselves against future uncertainties. The average time lag between policy purchase date and claim date is 9.65 years,[42] implying that some may be willing to risk uncertainties regarding their health rather than pay insurance premiums for over 9 years before reaping the benefits.

To improve the likelihood of policy purchase, the federal government and state governments offer tax incentives. The relevant literature is mixed on the effectiveness of tax incentives. Goda (2011), after adjusting policy premiums for tax incentives, finds that tax incentives induce the purchase of long-term care insurance. Using multi-state data, she specifically finds the average tax subsidy increases purchase rates by 28%. However, Courtemanche and He (2009)[43] find that tax incentives alone are unlikely to motivate consumer purchases of policies (see also Brown and Finkelstein, 2011 who find that while tax incentives may increase private insurance demand on the margin, they are unlikely to substantially impact the aggregate elderly population). Courtemanche and He find that individuals who itemized medical expenses prior to the tax deduction associated with long-term care insurance are 0.5 percentage points more likely to purchase long-term care insurance, suggesting that they do not respond to the tax incentive. The authors extend their analysis to the general population and find that seniors are 3.3 percentage points more likely to own long-term care insurance. Courtemanche and He additionally find a price elasticity of -3.9, suggesting that if the tax deduction decreases insurance premium prices by 10%, consumers respond by purchasing 39% more policies. However, this elasticity likely overstates consumer responses for Indiana, as the Indiana tax deduction would reduce premium prices by potentially 4.8% (based on 3.4% state income tax rate and the median local income tax rate of 1.4%). Based on the estimated price elasticity, a 4.8% reduction in price could lead to an 18.7% increase in policy purchases.

According to Weiner et al. (2000), long-term care partnership programs have not significantly impacted the financing of long-term care via reduced taxpayer reliance on Medicaid as intended by state legislatures. The enactment of tax subsidies for the purchase of long-term care insurance by 24 states plus the District of Columbia has, according to Weiner, marginally improved the frequency of policy purchases.

Consumer Knowledge of the Tax Deduction

The average age of all insured partnership policyholders is 56 (includes individual policyholders, group certificate holders and organization-sponsored). Policyholders who do not complete their own taxes may be unaware of the tax deduction due to their accountants' lack of knowledge. Or, an insurance policy agent may have failed to explain the tax deduction to the policyholder.

Additionally, 41 of the 50 states have reciprocity policies, whereby they honor partnership policies from other states that disregard Medicaid's asset spend-down policy.[38] Some individuals may retire and decide to move from Indiana to any of the other 40 states with reciprocity policies. They may claim the tax deduction on long-term care policy premiums if their destination state offers it. This may help explain the low incidence of tax deduction claims.

Tax Savings

Insurance premiums differ across individuals by age and gender and range from $4,500 to $14,800

[42] Indiana Long-term Care Insurance Program. Quarterly Statistics Report. http://www.in.gov/iltcp/2335.htm.
[43] Courtemanche, Charles, and Daifeng He. (2009). Tax incentives and the decision to purchase long-term care insurance. Journal of Public Economics, February 2009.

annually, with an average of $7,998. The annual state tax savings could range from $155 to $502, with an average of $279. The local tax savings, based on the average rate of 1.4%, range from $63 to $207, with an average of $112. As stated by the program director of the Indiana Department of Insurance, the tax deduction provides "a cherry on top" of the decision to purchase insurance but does not necessarily influence that decision.[44]

Economic Impact of Tax Incentive

Generally speaking, the tax deduction reduces revenue to the government. However, the decline in Medicaid expenditures resulting from purchases of long-term care insurance presents savings to the government. Whether the total impact is positive depends on if the deduction encourages enough people to purchase and use long-term care insurance benefits rather than Medicaid.
Let's examine the revenue loss from the tax deduction first. The average deduction claim amount based on 2012 (see Table 14) is $2,783, which indicates the amount that each individual pays in premiums annually. The state and local income tax savings to and revenue loss due to each taxpayer is about $134. The revenue loss from the tax deduction amounts to approximately $1.36 million in state revenue and $559,000 in local income tax revenue assuming the median local tax rate of 1.4%. This is a total state and local revenue loss of $1.9 million.

Now let's examine Medicaid expenditures. Total Medicaid spending for long-term care in Indiana during FY 2012 was $700 million.[45] Average annual Medicaid expenditures on nursing home care costs are over $42,000,[46] giving an idea of the amount of savings to the state and federal governments every time an individual chooses long-term care insurance over Medicaid coverage. Recall that long-term care insurance does not necessarily cover all home care and nursing home expenditures (e.g., average daily nursing home benefits paid by partnership long-term care insurance during 2012 were $147, while the average daily nursing home cost ranged from $200-$235[47]), exposing individuals to the remaining cost burden. However, very few individuals have exhausted their insurance benefits and turned to Medicaid for the coverage of their remaining costs. Although 0.2% of Hoosiers have exhausted their benefits to date, only half of those have applied to Medicaid and the other half have presumably shouldered those expenses through other income streams.

Chart 2 shows that Partnership Program policies providing total asset protection coverage were purchased prior to 1998. However, prior to 1998, dollar-for-dollar coverage was the only option available. SEA 101-1998 offered total asset protection under certain guidelines and also provided that policies purchased prior to 1998 that met those guidelines would be granted total asset protection coverage.

Chart 2 indicates that since 1998, policyholders have preferred total asset protection. This means the total assets of most policyholders are protected and thereby unavailable for long-term care expenditures. While total asset protection provides financial flexibility to policyholders, it presents an opportunity cost to state government, which provides Medicaid to eligible individuals when they exhaust their policy benefits and lack the necessary funds to cover long-term care expenses.

Based on Chart 2, over 1,000 partnership policies were purchased during 2012, a 61% decline from

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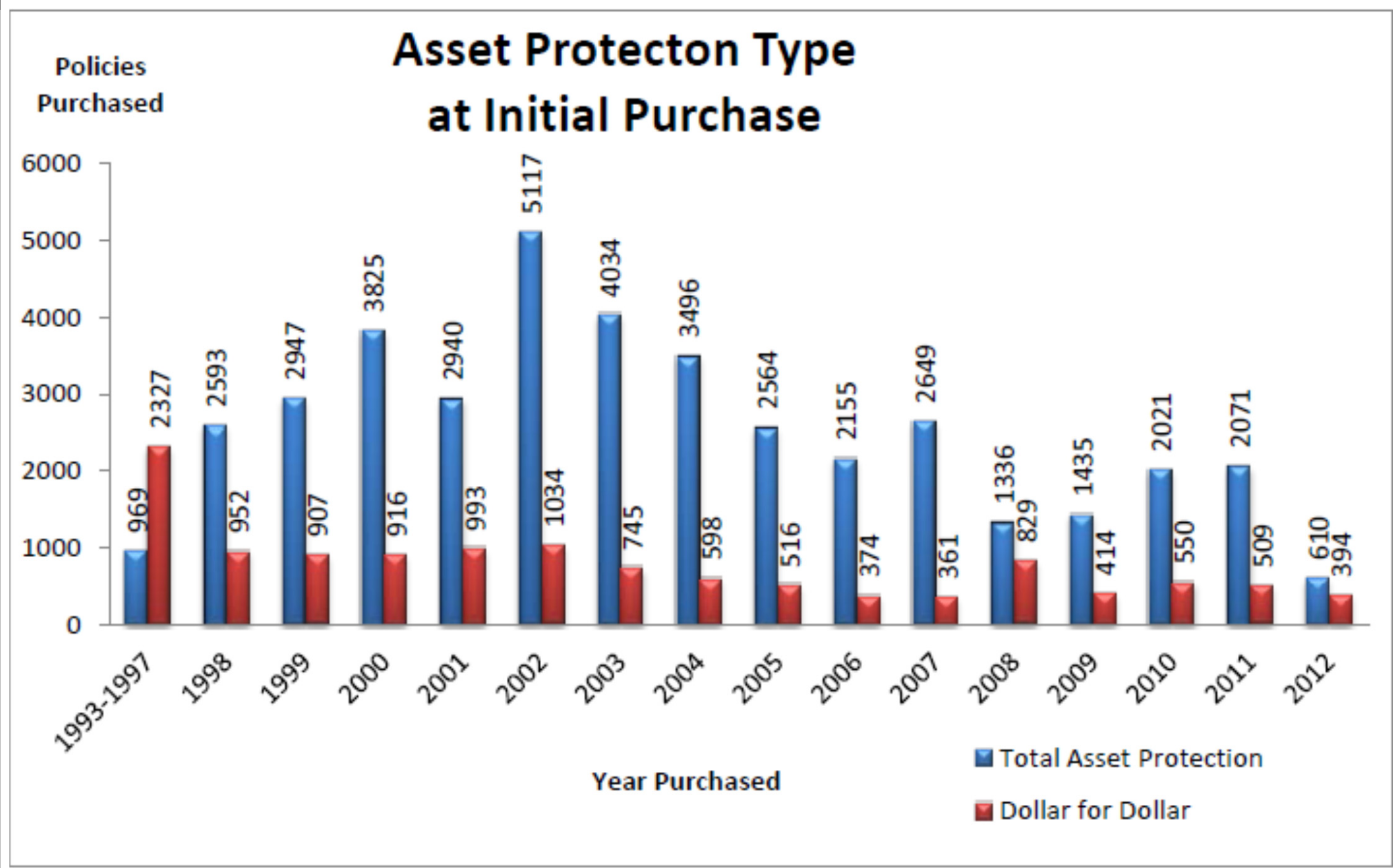
[44] Vaughan, Rebecca. Indiana Department of Insurance. rvaughan@igoi.in.gov.

[45] Budget Committee Forecast Presentation. Indiana Family and Social Services Administration. Dec. 20, 2013.

[46] Office of Medicaid Policy and Planning. Indiana Family and Social Services Administration.

[47] Cost of Care Survey 2014. https://www.genworth.com/corporate/about-genworth/industry-expertise/cost-of-care.html.

Chart 2. Long-Term Care Partnership Policies by Asset Protection, 1993-2012



Source: Indiana Department of Insurance

the prior year. As the tax deduction went into effect during 2000, one may initially expect the total number of policy purchases to rise as a result of that deduction. Although we notice a general decline in year-over-year policy purchases, the total number of purchases to date has risen over time. However, we are aware of some factors that may have driven the overall increase. One is that total asset protection became available beginning 1998. Chart 2 clearly shows that policy purchasers responded to SEA 101 by purchasing significantly more policies with total asset protection than prior to 1998. Another refers to the general economic patterns of the 2000s. We notice that following the first recessionary period, total policy purchases increased drastically by 56% from 2001 to 2002. We notice the same pattern following the second recessionary period, albeit less severe. Policy purchases increased by 39% from 2009-2010. Of course there may even be other factors that influenced the declining growth rate of policy purchases. Based on these factors, we cannot definitively say whether the tax deduction had any significant influence.

Tax Exemptions

Exemptions Included: **Personal**
Dependent
Dependent Child
Elderly/Blind
Low-Income Elderly

Background

This section of the report covers five exemptions:

(1) The personal exemption
(2) The dependent exemption
(3) The dependent child exemption
(4) The elderly/blind exemption
(5) The low-income elderly exemption

These exemptions may be claimed by individual income taxpayers and provide that some subsistence level of income is not subject to taxation, with the level varying depending on whether the taxpayer meets certain conditions like being married, having children, being elderly, or being blind. The following subsections provide general details on each exemption.

Personal Exemption

An individual taxpayer may claim an exemption of $1,000 for himself or herself, plus an additional exemption of $1,000 for his or her spouse if the taxpayer files a joint return. This exemption is aligned with the personal exemption under the federal income tax for a taxpayer and taxpayer's spouse. The personal exemption was enacted in 1963 and effective beginning in 1963. The $1,000 exemption for a taxpayer has not changed since 1963. The exemption level for a spouse on a joint return was the lesser of the spouse's income or $1,000, with a minimum of $500 until 1985. Beginning in 1985, the exemption level for a spouse was set at $1,000.

Taxpayers claim the exemption on the IT-40EZ, IT-40 Schedule 3, and IT-40PNR Schedule D tax forms. The exemption reduces a taxpayer's Indiana adjusted gross income before the application of the tax rate and saves the taxpayer $68 (given the maximum exemption of $2,000 and tax rate of 3.4%). For the local option income tax, the taxpayer saves $28 (based on the median local option income tax (LOIT) rate of 1.4%) on the maximum $2,000 exemption.

Dependent Exemption

A taxpayer may claim an exemption of $1,000 for each of the taxpayer's dependents. This exemption is aligned with the federal dependent exemption so a dependent can be a child or grandchild of the taxpayer, a relative of the taxpayer, or other person residing with the taxpayer who meets certain dependency requirements. The dependent exemption was enacted in 1963 and effective beginning in 1963. The dependent exemption was $500 until 1985 when the exemption level was increased to $1,000.

Taxpayers claim the exemption on the IT-40EZ, IT-40 Schedule 3, and IT-40PNR Schedule D tax forms. The exemption reduces a taxpayer's Indiana adjusted gross income before the application of the tax rate and saves the taxpayer $34 (given the maximum exemption of $1,000). For the local option income tax, the taxpayer saves $14 (based on the median LOIT rate).

Dependent Child Exemption

A taxpayer may claim an exemption of $1,500 for each dependent child of the taxpayer. A dependent child must be a daughter, stepdaughter, son, stepson or foster child and must be under the age of 19 or a full-time student under the age of 24. The $1,500 exemption per dependent child is in addition to the dependent exemption described above. The dependent child exemption was enacted in 1997 and effective beginning in 1997. The exemption was $500 per dependent child until 1999 when it was increased to $1,500.

Taxpayers claim the exemption on the IT-40EZ, IT-40 Schedule 3, and IT-40PNR Schedule D tax forms. Taxpayers are also required to submit form IN-DEP along with their return to claim the exemption. The IN-DEP asks the taxpayer to provide the child's first and last name and the child's social security number or taxpayer identification number.

The exemption reduces a taxpayer's Indiana adjusted gross income before the application of the tax rate and saves the taxpayer $51 (given the maximum exemption of $1,500). For the local option income tax, the taxpayer saves $21 (based on the median LOIT rate).

Elderly/Blind Exemption

This exemption allows a taxpayer who is at least 65 years old or blind to claim an exemption of $1,000. A taxpayer who meets both conditions may claim $2,000. Consequently, the maximum exemption amount for a joint filer under this provision is $4,000 provided the taxpayer and the taxpayer's spouse meet both conditions. The elderly/blind exemption was enacted in 1963 and effective beginning in 1963. The exemption level was $500 per exemption until 1985 when it was increased to $1,000.

Taxpayers claim the exemption on the IT-40EZ, IT-40 Schedule 3, and IT-40PNR Schedule D tax forms. The Indiana exemption and the federal exemption share the same eligibility criteria. The exemption reduces a taxpayer's Indiana adjusted gross income before the application of the tax rate and saves the taxpayer $34 (given an exemption of $1,000). For the local option income tax, the taxpayer saves $14 (based on the median LOIT rate).

Low-Income Elderly Exemption

This exemption allows a taxpayer who is at least 65 years old to claim an exemption of $500 provided the taxpayer's adjusted gross income is less than $40,000. In the case of joint return, the taxpayer and taxpayer's spouse may claim $500 each if both are at least 65 years old. Consequently, the maximum exemption is $1,000, if both the taxpayer and the taxpayer's spouse are over 65 and have adjusted gross income of less than $40,000. This exemption was enacted in 1999 and effective in 1999. The exemption levels and the income requirement have not changed since.

Taxpayers claim the exemption on the IT-40EZ, IT-40 Schedule 3, and IT-40PNR Schedule D tax forms. The Indiana exemption and the federal exemption share the same eligibility criteria. The exemption reduces a taxpayer's Indiana adjusted gross income before the application of the tax rate and saves the taxpayer $17 (given an exemption of $500). For the local option income tax, the taxpayer saves $7 (based on the median LOIT rate).

Exemption Claims History

Table 16 exhibits the number of claims and total claim amounts by exemption for 2012. This provides an idea of the magnitude of claims for each exemption. Taxpayers claimed about $4.2 billion in personal exemptions, followed by about $2.5 billion in dependent child exemptions, and about $2.0 billion in dependent exemptions. The elderly/blind and low-income elderly exemptions combined for claims of about $972 million. The total claimed under all five exemptions was $9.7 billion. The revenue impact of these exemption claims totaled about $330.8 million in state income

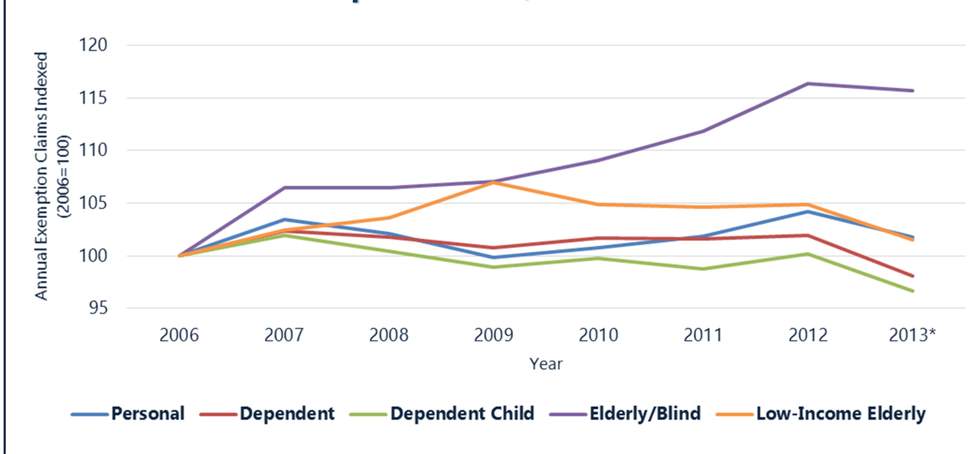
tax revenue and $136.2 million in local income tax revenue.

Table 16. Number of Claims and Amount by Exemption, 2012

Exemption	Number of Claims	Total Claim Amount
Personal	3,105,923	$4,217,624,546
Dependent	1,098,611	$2,026,647,088
Dependent Child	951,693	$2,512,813,949
Elderly/Blind	554,840	$747,934,927
Low-Income Elderly	339,693	$223,046,301

Source: OFMA Income Tax Databases and U.S. Census Bureau: American Community Survey

As we would expect from Table 16, the number of personal exemption claims overwhelmingly outnumber those of the other four exemptions from 2006 to 2013. Chart 3 exhibits the trends in exemption claims from 2006 to 2013. Claims of each exemption have generally risen over the study period, with all but the elderly/blind exemption increasing only slightly on an average annual basis. While the number of taxpayers claiming the elderly/blind exemption increased by an average of about 2.6% per year from 2006 to 2012, the other exemptions each experienced annual growth averaging less than 1%. The increase in the elderly/blind exemption reflects the rising population aged 65 years and over. However, claims for the personal exemption increased by 2.3% from 2011 to 2012. Likewise, claims for the dependent child exemption increased 1.4% for the same period. The numbers of dependents and dependent children claimed tended to decline over the past couple of years.



Exemption Claims for Tax Year 2012

Chart 4 exhibits the income distribution of personal, dependent, and dependent child exemption claims for tax year 2012. The income ranges are based on taxpayers' federal adjusted gross income. Note that personal exemptions were claimed on nearly all tax returns for every income range above $1. Income does not appear to influence taxpayer decisions to claim the exemption. However, the largest percent of dependent child exemptions (about 50%) were claimed by taxpayers with incomes of $100,000 or more. Dependent exemptions were claimed by marginally more taxpayers than dependent child exemptions because the definition of a dependent is broader than that for a dependent child.

Chart 5 exhibits the income distribution of elderly/blind and low-income elderly exemption claims for tax year 2012. Again, the income ranges are based on taxpayers' federal adjusted gross income. Elderly/blind and low-income elderly exemptions were claimed by at most 25% of the taxpayers within any of the income ranges. The low-income elderly exemption is allowed only for taxpayers whose adjusted gross incomes are less than $40,000. There is no income restriction for the elderly/blind exemption. The share of claims by income range is highest for low incomes, then falling for middle income taxpayers, and generally rising in the relatively high income ranges.

Economic Impact

Household expenditures of the tax savings from the personal, dependent, dependent child, elderly/blind, and low-income elderly exemptions can be generalized across 15 sectors as defined by IMPLAN (Chart 6). Households tend to spend their savings on goods and services provided by these sectors and thereby contribute to their level of employment, labor income and output, which reflects the total value of purchases by consumers. Demand for those goods and services drives their supply, and industries must employ enough workers to produce that supply.

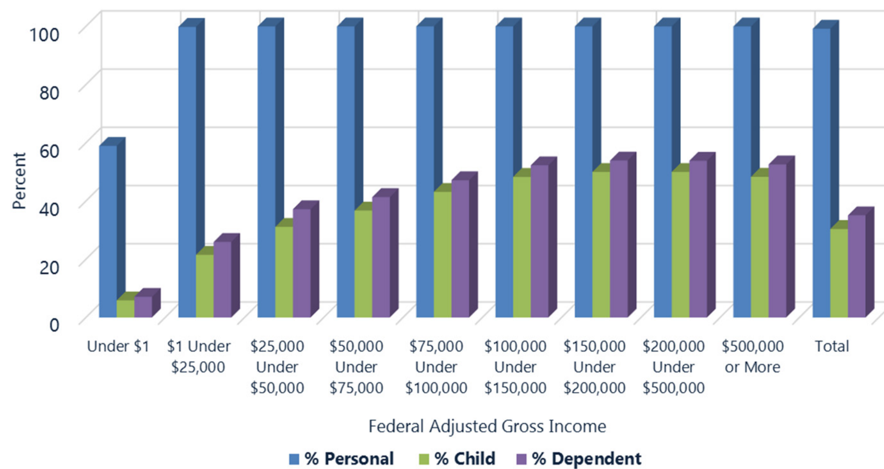


Chart 4. Personal, Child and Dependent Exemption Claims as Percent of 2012 Tax Returns by Income Range

Source: OFMA Income Tax Databases and U.S. Census Bureau: American Community Survey

The IMPLAN data provide us with an idea of how and where households spend their savings. Households tend to spend their tax savings from the five exemptions across 15 sectors, of which food and medical services account for the greatest expenditures. Industries attempt to meet household demand for certain goods and services with adequate supply, for which they need to employ workers and pay them wages and salaries. Of course, while some sectors may employ relatively many people, they may not pay them high salaries, which drives down aggregate labor income. Finally, high employment and/or high labor income may not be met with high output, as output reflects total value to consumers. Accordingly, the data the highest value on homes based on the sector referred to as imputed rent for homeowners. indicate that consumers place

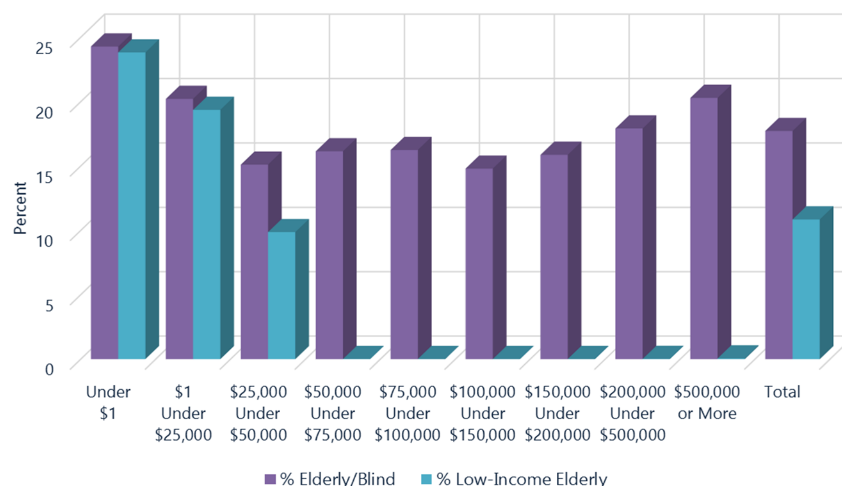
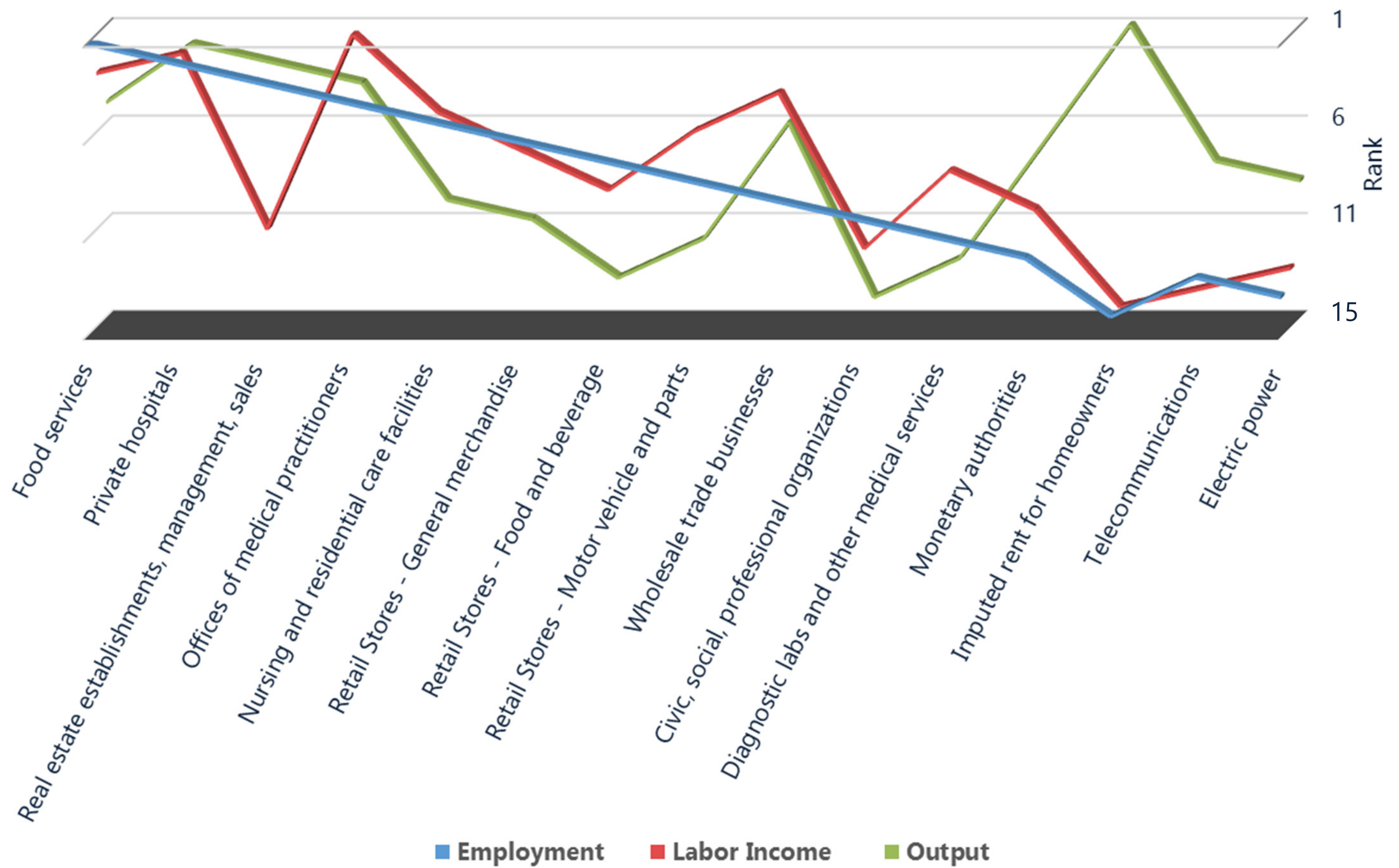


Chart 5. Elderly/Blind and Low-Income Elderly Exemption Claims as Percent of 2012 Tax Returns bv Income

Source: LSA Income Tax Database and U.S. Census Bureau: American Community Survey

Chart 6. Ranking of Spending Impacts by Top 15 Industry Sectors



Source: IMPLAN

Renter's Deduction

(IC 6-3-2-6)

- Enacted in 1979; effective in 1979
- Deduction equals up to $3,000 of the rent paid for a principal place of residence.

Background

The Renter's Deduction was enacted in 1979 and went into effect in 1979. The purpose of the renter's deduction is to provide tax relief to renters for rent paid on a principal place of residence that is subject to property tax. The deduction equals up to $3,000 of rent paid for a principal place of residence during the tax year. The monetary limit on the deduction has been increased three times since the initial deduction limit of $1,500. The deduction limit was increased to $2,000 in 1999 and $2,500 in 2003. The increase to $3,000 was first effective in 2008.

The deduction reduces the taxpayer's Indiana adjusted gross income before the application of the income tax rate. The tax savings from the deduction equals the deduction amount multiplied by the tax rate. Consequently, the maximum $3,000 deduction will reduce the state income tax liability by $102 and the local option income tax (LOIT) liability by $42 based on the median LOIT rate of 1.4%.

Taxpayers claim the deduction on the IT-40EZ, IT-40 Schedule 2, and IT-40PNR Schedule C tax forms. The $3,000 deduction limit is the same for individual filers and married couples filing jointly. The renter of a mobile home or the owner of a mobile home who pays rent for land use may claim this deduction, provided the mobile home is the taxpayer's principal place of residence.[48]

Tax Provision Claims

Table 17 reports the claims history for the renter's deduction since 2006 and compares the claims with renter-occupied housing unit totals. The table also reports the median monthly rent for each year. The annual claims of the deduction are rather stable with the exception of 2009, likely as a result of the

Table 17: Renter's Deduction Claim History

Tax Year	Number of Claims	% Change of Claims	Claim Amount	% Change in Claim Amount	Renter-Occupied Housing Units**	Median Monthly Rent*
2006	652,006		$1,504,736,080		678,946	$638
2007	673,761	3%	1,556,965,514	3%	698,544	638
2008	680,615	1%	1,840,706,695	18%	654,763	670
2009	606,705	(11%)	1,674,760,652	(9%)	687,184	687
2010	627,130	3%	1,730,376,009	3%	685,629	683
2011	653,177	4%	1,809,708,612	5%	705,853	707
2012	662,287	1%	1,826,950,167	1%	719,233	715
2013**	667,063		1,844,686,688			

Source: OFMA income tax return databases.

*U.S. Census Bureau, American Community Survey.

**The 2013 filer counts and credit amounts are not full-year totals because of filing extensions and suspension of returns for audit.

[48] Indiana Department of State Revenue, Information Bulletin #38, May 2008.

Great Recession. Claim amounts spiked in 2008 (an 18% increase) because the deduction limit increased by 20%, from $2,500 to $3,000. The number of claimants and the claim amount increased by an annual average of about 2.9% from 2009 to 2012. This growth is higher than the growth in the median monthly rent, which rose by an average of only 1.3% during that period. Based on the median monthly rent in 2012 ($715), the deduction allows an average renter to deduct somewhat more than four months of rent from his or her adjusted gross income.

The total deductions claimed in 2012 ($1.8 billion) resulted in a state revenue loss of about $62.1 million and a local revenue loss of about $25.6 million based on the median LOIT rate.

Table 18 reports the income distribution of the deduction for tax year 2012. Almost all of the deduction amount claimed (93.4%) is attributable to taxpayers with incomes between $1 and $75,000. Just over 50% of the deduction amount claimed is attributable to taxpayers with incomes between $1 and $25,000. The impact of the deduction on the tax liability of deduction claimants declines substantially as income increases because the deduction is a fixed dollar amount. However, for those with incomes below $50,000, the tax liability impact ranges from 10% to almost 47%. Even between $50,000 and $100,000 the tax liability impact ranges from 3.7% to 5.5%

Table 18: Income Distribution of Renter's Deduction Claims for Tax Year 2012

Federal Adjusted Gross Income	Total Number of Returns	Number of Deduction Claims	Deduction Amount	Distribution of Deduction Amount	% Change in Claimant Tax Liability
Under $1	100,769	3,564	$9,482,616	0.5%	46.9%
$1 Under $25,000	1,316,606	346,063	928,014,554	50.8%	30.7%
$25,000 Under $50,000	724,677	209,568	594,751,972	32.6%	10.0%
$50,000 Under $75,000	417,978	64,103	183,410,933	10.0%	5.5%
$75,000 Under $100,000	264,758	22,090	63,020,179	3.4%	3.7%
$100,000 Under $150,000	218,491	11,858	33,818,282	1.9%	2.6%
$150,000 Under $200,000	63,205	2,726	7,746,653	0.4%	1.8%
$200,000 Under $500,000	55,981	2,037	5,903,994	0.3%	1.1%
$500,000 or More	14,607	278	800,984	0.0%	0.2%

Source: OFMA income tax return databases.

Homeowner's Property Tax Deduction

(IC 6-3-1-3.5(a)(15))

- Enacted in 1979; effective in 1979
- Deduction equals up to $2,500 of the property tax paid on a principal place of residence.

Background

The Homeowner's Property Tax deduction was enacted in 1979 and went into effect in 1979. The purpose of the homeowner's property tax deduction is to reduce or eliminate the income tax on an individual's income used to pay property taxes on the taxpayer's principal place of residence in Indiana. In essence, the deduction appears to be aimed at eliminating the double taxation of income.

The deduction equals the property taxes paid by the taxpayer on his or her principal place of residence in Indiana up to $2,500. The monetary limit on the deduction has not changed since the deduction was enacted. The deduction reduces the taxpayer's Indiana adjusted gross income before the application of the income tax rate. The tax savings from the deduction equals the deduction amount multiplied by the tax rate. The maximum $2,500 deduction will reduce the state income tax liability by $85, and the local option income tax (LOIT) liability by $35 based on the median LOIT rate of 1.4%.

Taxpayers claim the deduction on IT-40, Schedule 2 and IT-40PNR, Schedule C. Each schedule has a dedicated line for the deduction. Taxpayers are asked to provide the address of their principal place of residence if it is different than the address on their tax returns. A principal place of residence is the place where the taxpayer has a true, fixed home that they intend to return to after being absent. Taxpayers are also instructed to maintain copies of proof that the property tax was paid. The DOR may require the taxpayer to supply this information at a later date.

Tax Provision Claims

Table 19 reports the claims history for the homeowner's property tax deduction since 2006

Table 19: Homeowner's Property Tax Deduction Claim History

Tax Year	Number of Claims	% Change of Claims	Claim Amount	% Change in Claim Amount	Average Claim Amount	Average Homestead Property Tax Bill
2006	1,385,267		$1,728,092,113		$1,247	$1,299
2007	1,413,072	2.0	1,912,414,823	10.7	1,353	1,040
2008	1,429,018	1.1	1,546,540,726	(19.7)	1,082	1,100
2009	1,417,475	(0.8)	1,622,866,984	4.9	1,145	1,114
2010	1,421,745	0.3	1,620,815,129	(0.1)	1,140	1,173
2011	1,413,544	(0.6)	1,613,525,574	(0.4)	1,141	1,159
2012	1,407,228	(0.4)	1,617,879,208	0.3	1,150	1,179
2013*	1,360,718		1,557,510,236		1,145	1,188

Source: OFMA income tax return databases.

*The 2013 filer counts and credit amounts are not full-year totals because of filing extensions and suspension of returns for audit.

and compares the claims with the average homestead property tax bill. The significant growth in the claim amount prior to 2008 has slowed substantially since the 2008 property tax reforms. In 2008, the claim amount and average claim amount declined by 19.7%. Since 2008 these amounts as well as the number claiming the deduction have been flat. The comparison of the average claim amount and the average homestead property tax bill suggests that most taxpayers are able to deduct their entire property tax bill, as the average tax bill is less than half the monetary limit of the deduction.

The total deductions claimed in 2012 ($1.6 billion) resulted in a state revenue loss of about $55.0 million and a local revenue loss of about $22.7 million based on the median LOIT rate.

Table 20 reports the income distribution of the deduction for tax year 2012. Not surprisingly, the deduction amount claimed is distributed over a broad range of incomes. While the largest share of the deduction amount claimed is attributable to taxpayers with incomes between $50,000 and $75,000, this is still only 19% of the total deduction amount claimed. Roughly 84.2% of the deduction amount claimed is attributable to taxpayers with incomes between $1 and $150,000. The impact of the deduction on the tax liability of deduction claimants declines substantially as income increases because the deduction is a fixed dollar amount. The tax liability impact tops out at about 7% to 8% for the lowest income ranges, but then falls off precipitously. The tax liability impact falls to somewhat less than 3% for taxpayers with incomes between $25,000 and $50,000 income range and then falls to less than 2% for higher incomes.

Table 20: Income Distribution of Homeowner's Property Tax Deduction Claims for Tax Year 2012

Federal Adjusted Gross Income	Total Number of Returns	Number of Deduction Claims	Deduction Amount	Distribution of Deduction	% Change in Claimant Tax Liability
Under $1	100,769	12,682	$15,918,530	1.0%	6.97%
$1 Under $25,000	1,316,606	258,389	198,685,708	12.3%	7.70%
$25,000 Under $50,000	724,677	315,263	280,262,321	17.3%	2.87%
$50,000 Under $75,000	417,978	291,589	307,039,003	19.0%	1.96%
$75,000 Under $100,000	264,758	218,362	274,640,879	17.0%	1.64%
$100,000 Under $150,000	218,491	192,711	300,161,394	18.6%	1.42%
$150,000 Under $200,000	63,205	56,553	106,897,400	6.6%	1.18%
$200,000 Under $500,000	55,981	49,167	105,059,907	6.5%	0.78%
$500,000 or More	14,607	12,512	29,214,066	1.8%	0.18%

Source: OFMA income tax return databases.

Medical Savings Account Contribution Deduction

(IC 6-3-2-18)

- Enacted in 1995; effective in 1996
- Deduction for certain contributions to an MSA.

Background

The medical savings account (MSA) contribution deduction allows a taxpayer to deduct his or her contributions to an Archer MSA that have not otherwise been deducted from the taxpayer's federal adjusted gross income.

Archer MSAs were authorized for self-employed individuals and employees of small businesses (generally businesses with 50 or fewer employees). The MSA must be used in combination with a high-deductible health plan (HDHP). If the taxpayer is self-employed, he or she provides for the HDHP and makes contributions to the MSA. If the taxpayer is employed by a small business, the employer provides the HDHP, and contributions to the MSA may be made by either or both the employer and employee.

Contributions to the MSA by an employee of a small business or a self-employed individual are deductible from federal adjusted gross income. Employer contributions to an MSA are excluded from the taxpayer's gross income, and distributions from the MSA for qualified expenses are not taxable.

Use of Archer MSAs was restricted after 2007. Active participants in MSAs before 2008 continue to be eligible to participate in their MSA. New MSAs could not be established after 2007 unless an individual became an active participant because he or she is employed by an employer that participated in an MSA program before 2008.

Tax Provision Claims

Table 21 exhibits the MSA contribution deduction claim histories for the period 2006 to 2013. The number of deduction claims and the amount claimed fluctuated substantially over the study period. Claim numbers were highest during 2008, but the amount claimed was highest in 2011. The number of claims have declined significantly since 2008, with the 2012 claims being 46.7% below the 2008 level. The largest year-over-year decline in claims and the amount claimed occurred in 2012. This may be indicative of overall usage declining or phasing out over time because of the federal restriction on new MSAs being established after 2007.

Table 21: Medical Savings Account Contribution Deduction Claim History

Tax Year	Number of Claims	% Change of Claims	Claim Amount	% Change in Claim Amount
2006	696		$770,503	
2007	977	40.37%	1,262,684	63.88%
2008	1,456	49.03%	2,055,252	62.77%
2009	1,287	-11.61%	1,867,224	-9.15%
2010	1,225	-4.82%	2,045,913	9.57%
2011	1,169	-4.57%	2,189,926	7.04%
2012	778	-33.45%	1,414,522	-35.41%
2013**	849		1,653,632	

Source: OFMA tax return databases.

*The 2013 filer counts and credit amounts are not full-year totals because of filing extensions and suspension of returns for audit.

The total deductions claimed in 2012 ($1.4 million) resulted in a state revenue loss of about $48,000 and a local revenue loss of about $20,000 based on the median LOIT rate.

Table 22 reports the income distribution of the deduction for tax year 2012. About 42.5% of the deduction amount claimed is attributable to taxpayers with incomes between $25,000 and $75,000, with most of the deduction amount claimed (76.8%) attributable to taxpayers with incomes between $25,000 and $150,000. Still, over 9% of the deduction amount claimed is attributable to taxpayers with incomes below $25,000. The impact of the deduction on the tax liability of deduction claimants declines substantially as income increases. While the tax liability impact is about 10.7% for taxpayers with incomes between $1 and $25,000, it declines to between 3% and 5% for taxpayers with incomes ranging from $25,000 to $100,000. From there the tax liability impact declines to 2% or below for taxpayers with incomes above $100,000.

Table 22: Income Distribution of Medical Savings Account Contribution Deduction Claims for Tax Year 2012

Federal Adjusted Gross Income	Total Number of Returns	Number of Deduction Claims	Deduction Amount	Distribution of Deduction Amount	% Change in Claimant Tax Liability
Under $1	100,769	5	$3,314	0.2%	0%
$1 Under $25,000	1,316,606	117	151,022	9.1%	10.7%
$25,000 Under $50,000	724,677	231	358,195	21.7%	5.0%
$50,000 Under $75,000	417,978	185	344,534	20.8%	3.5%
$75,000 Under $100,000	264,758	108	261,094	15.8%	3.1%
$100,000 Under $150,000	218,491	130	306,197	18.5%	2.2%
$150,000 Under $200,000	63,205	32	68,963	4.2%	1.4%
$200,000 Under $500,000	55,981	34	119,231	7.2%	1.3%
$500,000 or More	14,607	7	41,082	2.5%	0.6%

Source: OFMA income tax return databases.

Appendix 1: HEA 1020-2014

Chapter 3.2. Review, Analysis, and Evaluation of Tax Incentives

2-5-3.2-1

Year Enacted 2014; Year Amended 2014

Sec. 1. (a) As used in this section, "tax incentive" means a benefit provided through a state or local tax that is intended to alter, reward, or subsidize a particular action or behavior by the tax incentive recipient, including a benefit intended to encourage economic development. The term includes the following:

(1) An exemption, deduction, credit, preferential rate, or other tax benefit that:

(A) reduces the amount of a tax that would otherwise be due to the state;

(B) results in a tax refund in excess of any tax due; or

(C) reduces the amount of property taxes that would otherwise be due to a political subdivision of the state.

(2) The dedication of revenue by a political subdivision to provide improvements or to retire bonds issued to pay for improvements in an economic or sports development area, a community revitalization area, an enterprise zone, or a tax increment financing district.

(b) The general assembly intends that each tax incentive effectuate the purposes for which it was enacted and that the cost of tax incentives should be included more readily in the biennial budgeting process. To provide the general assembly with the information it needs to make informed policy choices about the efficacy of each tax incentive, the commission on state tax and financing policy (or its successor committee) shall conduct a regular review, analysis, and evaluation of all tax incentives according to a schedule developed by the commission.

(c) The legislative services agency, under the direction of the commission, shall conduct a systematic and comprehensive review, analysis, and evaluation of each tax incentive scheduled for review by the commission. The review, analysis, and evaluation must include information about each tax incentive that is necessary to achieve the goals described in subsection (b), such as any of the following:

(1) The basic attributes and policy goals of the tax incentive, including the statutory and programmatic goals of the tax incentive, the economic parameters of the tax incentive, the original scope and purpose of the tax incentive, and how the scope or purpose has changed over time.

(2) The tax incentive's equity, simplicity, competitiveness, public purpose, adequacy, and extent of conformance with the original purposes of the legislation enacting the tax incentive.

(3) The types of activities on which the tax incentive is based and how effective the tax incentive has been in promoting these targeted activities and in assisting recipients of the tax incentive.

(4) The count of the following:

(A) Applicants for the tax incentive.

(B) Applicants that qualify for the tax incentive.

(C) Qualified applicants that, if applicable, are approved to receive the tax incentive.

(D) Taxpayers that actually claim the tax incentive.

(E) Taxpayers that actually receive the tax incentive.

(5) The dollar amount of the tax incentive benefits that has been actually claimed by all taxpayers over time, including the following:

(A) The dollar amount of the tax incentive, listed by the North American Industrial Classification System (NAICS) Code associated with the tax incentive recipients, if an NAICS Code is available.

(B) The dollar amount of income tax credits that can be carried forward for the next five (5) state fiscal years.

(6) An estimate of the economic impact of the tax incentive, including the following:

(A) A return on investment calculation for the tax incentive. For purposes of this clause, "return on investment calculation" means analyzing the cost to the state or political subdivision of providing the tax incentive, analyzing the benefits realized by the state or political subdivision from providing the tax incentive.

(B) A cost benefit comparison of the state and local revenue foregone and property taxes shifted to other taxpayers as a result of allowing the tax incentive, compared to tax revenue generated by the taxpayer receiving the incentive, including direct taxes applied to the taxpayer and taxes applied to the taxpayer's employees.

(C) An estimate of the number of jobs that were the direct result of the tax incentive.

(D) For any tax incentive that is reviewed or approved by the Indiana economic development corporation, a statement by the chief executive officer of the Indiana economic development corporation as to whether the statutory and programmatic goals of the tax incentive are being met, with obstacles to these goals identified, if possible.

(7) The methodology and assumptions used in carrying out the reviews, analyses, and evaluations required under this subsection.

(8) The estimated cost to the state to administer the tax incentive.

(9) An estimate of the extent to which benefits of the tax incentive remained in Indiana or flowed outside Indiana.

(10) Whether the effectiveness of the tax incentive could be determined more definitively if the general assembly were to clarify or modify the tax incentive's goals and intended purpose.

(11) Whether measuring the economic impact is significantly limited due to data constraints and whether

any changes in statute would facilitate data collection in a way that would allow for better review, analysis, or evaluation.

(12) Any additional review, analysis, or evaluation the commission considers advisable. Among other things, the commission and the legislative services agency are encouraged to include comparisons with tax incentives offered by other states if those comparisons would add value to the review, analysis, and evaluation.

The legislative services agency may request a state or local official or a state agency, a political subdivision, a body corporate and politic, or a county or municipal redevelopment commission to furnish information necessary to complete the tax incentive review, analysis, and evaluation required by this section. An official or entity presented with a request from the legislative services agency under this subsection shall cooperate with the legislative services agency in providing the requested information. An official or entity may require that the legislative services agency adhere to the provider's rules, if any, that concern the confidential nature of the information.

(d) The commission shall hold public hearings to receive information concerning tax incentives. On or before November 1, 2014, and each year thereafter, the commission shall submit a report to the legislative council, in an electronic format under IC 5-14-6, containing the results of the commission's review, analysis, and evaluation. The report must include at least the following:

(1) A detailed description of the review, analysis, and evaluation for each tax incentive reviewed.

(2) A recommendation as to whether a reviewed tax incentive should be continued, modified, or terminated, the basis for the recommendation, and the expected impact of the recommendation on the state's economy.

(3) Recommendations for better aligning a reviewed tax incentive with the original intent of the legislation that enacted the tax incentive.

(4) An estimate for each fiscal year of the next biennial budget of the cost of each tax incentive and the total cost of all tax incentives, including those not scheduled for review under this section. The estimates shall be provided to the chairperson and ranking minority member of the house committee on ways and means and the senate committee on appropriations for use in the preparation of the budget and to the general assembly to be used in the budget process.

(5) To the extent possible, an estimate of the indirect economic benefit or activity stimulated by the tax incentive.

The report required by this subsection must not disclose any proprietary or otherwise confidential taxpayer information.

(e) The general assembly shall use the commission's report to determine whether a particular tax incentive:

(1) is successful;

(2) is provided at a cost that can be accommodated by the state's biennial budget; and

(3) should be continued, amended, or repealed.

(f) The legislative services agency shall establish and maintain a system for making available to the public

information about the amount and effectiveness of tax incentives.

(g) The commission shall, before November 1, 2014, develop and publish on the general assembly's Internet web site a multi-year schedule that lists all tax incentives and indicates the year when the report will be published for each tax incentive reviewed. The commission may revise the schedule as long as the commission provides for a systematic review, analysis, and evaluation of all tax incentives and that each tax incentive is reviewed at least once every five (5) years.

(h) This section expires December 31, 2023.

Appendix 2 - Tax Incentive and Nonincentive Provisions and Descriptions

Corporate Income Tax/Individual Income Tax

Tax Provision	Description	Tax Incentive
21st Century Scholars Program Credit	50% of contributions to the 21st Century Scholarship Support Fund. The maximum credit is $100 for individuals and $200 for joint filers.	X
Adoption Tax Credit (Effective 2015)	10% of the federal adoption tax credit claimed for the year. The maximum credit equals $1,000 per eligible child. The credit goes into effect beginning January 1, 2015.	X
Alternative Fuel Vehicle Manufacturing Investment Credit	15% of qualified investments made between 2007 and 2016 to manufacture and assemble alternative fuel vehicles. Credits are approved by the IEDC. New credits not awarded after December 31, 2016.	X
Civil Service Annuity Income Deduction	Income from a civil service annuity less any social security or railroad retirement income. The maximum deduction is $2,000 per qualifying person.	
Coal Gasification Technology Investment Credit	10% of the first $500 M in qualified investment in an integrated coal gasification power plant (7% if the investment is in a fluidized-bed combustion unit) and 5% of the qualified investment exceeding $500 M (3% if the investment is in a fluidized-bed combustion unit). Credits are approved by the IEDC Board.	X
Community Revitalization Enhancement District Credit	Percent of qualified investments made in these areas as approved by the IEDC Board.	X
Community Revitalization Enhancement District Credit (Local)	Percent of qualified investments made in these areas as approved by the IEDC Board.	X
County Credit for the Elderly or Permanently Disabled	If taxpayer qualifies for the Federal Elderly Credit, the amount equals the federal credit multiplied by the fraction of the county tax rate over 0.15.	
Deduction for Human Services Recipients	Under certain circumstances, individuals who live in certain medical facilities may receive a deduction to reduce their tax liability to zero.	
Dependent Child Exemption	$1,500 for dependent child under the age of 19 or full-time students under the age of 24.	
Disability Retirement Income Deduction	Disability retirement income received by an individual who is less than 65, retired, and permanently and totally disabled. The maximum deduction is $5,200 per qualifying person.	

Tax Provision	Description	Tax Incentive
Earned Income Tax Credit	A refundable tax credit for certain families that have a modified adjusted gross income less than $43,100. The credit amount depends on the number of qualifying children and family income. The maximum credit for 2013 was $483.	X
Economic Development for a Growing Economy (EDGE) Credit	Incremental income tax withholdings of new or retained employees as approved by the IEDC Board.	X
Elderly/Blind Exemption	$1,000 for each individual aged 65 or over and/or blind.	
Enterprise Zone Employee Income Deduction	The lesser of 50% of earnings or $7,500 if the individual lives and works within an enterprise zone.	X
Enterprise Zone Employment Expense Credit	Allowed for increased employment expenditures, equal to the lesser of 10% multiplied by the increased wages or $1,500 multiplied by the number of qualified employees.	X
Enterprise Zone Investment Cost Credit	Percent of qualified investment in a business located in an entrprise zone approved by the IEDC.	X
Enterprise Zone Loan Interest Credit	Allowed for interest received from qualified loans.	X
Federal Exemption	$1,000 for the taxpayer, spouse, and each dependent claimed on the federal return.	
Headquarters Relocation Credit	Up to 50% of the costs incurred by an eligible business to relocate its headquarters, division or subdivision principal office, or research center to Indiana.	X
Historic Rehabilitation Credit	20% of qualified expenditures as approved by the DNR. The maximum statewide credit may not exceed $450,000 annually.	X
Home Insulation Deduction	Up to $1,000 for the purchase and installation of home insulation, weather stripping, storm doors, storm windows, and double-pane windows.	X
Homeowner's Property Tax Deduction	Up to $2,500 of property taxes paid on an individual's principal place of residence.	
Hoosier Business Investment Credit	Up to 10% of qualified nonlogistics business investments directly related to expanding the workforce in Indiana not to exceed the taxpayer's state tax liability. For logistics investments, the credit equals 25% of the additional qualified investment made during the taxable year. The total nonlogistics credit for all taxpayers is capped at $10 M per year, while the total logistics credit for all taxpayers is capped at $50 M per year. Credits are approved by the IEDC Board. New credits not awarded after December 31, 2016.	X
Hoosier Lottery Winnings Deduction	Up to the first $1,200 of the total prize money won.	

Tax Provision	Description	Tax Incentive
Indiana 529 College Savings Account Contribution Credit	20% of annual contributions to an Indiana College Choice 529 investment plan savings account. The maximum credit per taxpayer is $1,000.	X
Indiana Colleges and Universities Contribution Credit	50% of contributions to institutions of higher education up to $100 ($200 if filing a joint return).	X
Indiana Partnership Long-Term Care Insurance Premiums Deduction	Amount of premiums paid during the year on a qualified long-term care policy.	X
Individual Development Accounts Credit	50% of the amount contributed to a fund if the contribution is not less than $100 and not more than $50,000.	X
Industrial Recovery Credit	Percent of qualified investments as approved by the IEDC Board.	X
Lake County Homeowner's Property Tax Credit	Credit for property taxes paid by an individual on a home the taxpayer owns and resides within Lake County. AGI must be less than $18,600, and the taxpayer may not claim the deduction for property taxes paid on the home.	
Law Enforcement Rewards Deduction	Up to $1,000 of awards received by providing information that assisted in the arrest of a person.	X
Low-Income Elderly Exemption	$500 for each person 65 or older with an AGI less than $40,000.	
Medical Savings Account Contribution Deduction	Amount of employer deposits in certain medical care savings accounts.	
Military Service Income Deduction	Up to $5,000 of earned military pay to all active-duty Armed Forces Reserve and National Guard members. Taxpayers who are at least 60 years old and receiving retirement income or survivor's benefits may also claim the deduction.	
National Guard and Reserve Member Deduction	Qualifying military income of certain members of the reserve components of the armed forces and the Indiana National Guard.	
Natural Gas-Powered Vehicles (Effective 2014)	50% of the difference between the price of the qualified vehicle and a similar vehicle that is powered by a gasoline or diesel engine up to $15,000. The maximum credit per taxpayer is $150,000 per taxable year. The total amount of credits per year may not exceed the lesser of $3 M or the sales tax revenue attributable to natural gas fuel used in providing public transportation.	X
Neighborhood Assistance Credit	50% of contributions to approve projects that assist economically disadvantaged areas or to employ, train, or provide technical assistance to people who reside in these areas. The maximum is $25,000. Total tax credits may not exceed $2.5 M in a fiscal year.	X

Tax Provision	Description	Tax Incentive
Net Operating Losses Deduction	Indiana portion of net operating losses.	
Patent-Derived Income Deduction	Up to $5 M in income from plant or utility patents issued beginning in 2008 to businesses or organizations domiciled in Indiana.	X
Private School/Home School Expenses Deduction	$1,000 per dependent child for unreimbursed expenses of primary or secondary school education in private or home school.	
Railroad Retirement Income Deduction	Income from supplemental railroad retirement annuities.	
Railroad Unemployment and Sickness Benefit Deduction	Unemployment and sickness benefits issued by the U.S. Railroad Retirement Board included as taxable benefits on a federal return and not already deducted under the Indiana taxable Social Security deduction and/or the Indiana Railroad Retirement Benefits deduction.	
Rent Deduction	Up to $3,000 of rent paid on an individual's principal place of residence.	
Research Expense Credit	For certain qualified research expenses incurred.	X
Residential Historic Rehabilitation Credit	20% of qualified expenditures as approved by DNR for the preservation or rehabilitation of the taxpayer's principal residence. The maximum statewide credit may not exceed $250,000 annually.	X
School Scholarship Contribution Credit	50% of contributions to nonprofit K-12 school scholarship-generating organizations. Total tax credits may not exceed $2.5 M per fiscal year before FY 2012, $5 M per fiscal year in FY 2012 and FY 2013, and $7.5 M per fiscal year beginning in FY 2014.	X
Social Security Benefits Deduction	Benefits included in federal gross income.	
Solar-Powered Roof Vent/Fan Installation Deduction	Up to $1,000 deduction if a solar-powered roof vent or fan is installed on a building owned or leased by the taxpayer.	X
Special Rate for Income Derived Inside a Military Base	Rate is 5% of AGI that is derived from sources within a qualified area if the corporation locates its operations in the qualified area. Special rate applies during the year in which the corporation located in that area and the four succeeding years.	X
Unemployment Compensation Deduction	Portion of unemployment income reported on the federal return.	
Unified Tax Credit for the Elderly	Declining refundable credit for individuals with adjusted gross income less than $10,000. The value of the credit depends on income and marital status.	

Tax Provision	Description	Tax Incentive
Venture Capital Investment Credit	20% of annual qualified venture capital investment up to $500,000 for investment before 2011 and up to $1 M for investment between 2011 and 2016. Total new credits awarded may not exceed $12.5 M annually. New credits not awarded after December 31, 2016.	**X**

Sales Tax

Tax Provision	Description	Tax Incentive
Aircraft Parts	Materials, parts, equipment, and engines used in the repair, maintenance, refurbishment, remodeling, or remanufacturing of an aircraft or avionics system of an aircraft.	X
Aviation Fuel	Aviation gasoline, jet fuel, and fuel used as a substitute for aviation gasoline or jet fuel.	X
Cargo Trailers/RVs Sold to Certain Nonresidents	Sales of RVs and trailers to a resident of another state that has a reciprocal exemption.	X
Certain Aircraft	Aircraft purchased for rental or leasing if the annual amount of gross lease revenue is greater than or equal to 7.5% of the book value or net acquisition price. Any aircraft rented or leased for predominant use in public transportation. Aircraft sold to a person who is not an Indiana resident.	X
Certain Racing Equipment	Tangible personal property that comprises any part of a professional motor racing vehicle or a two-seater Indianapolis 500 style race car, excluding tires and accessories.	X
Computer Equipment Sold by Schools to Parents	Qualified hardware and software sold to parents of students by a school or educational service center.	
Food for At-Home Human Consumption	Food and food ingredients for at-home consumption, including food sold in an unheated state by weight or volume as a single item and bakery items.	
Lottery Tickets	All Indiana state lottery tickets.	
Manufacturing, Farming, and Public Utility Production Inputs	Certain tangible personal property acquired for direct use in the direct production of manufactured goods, food, food ingredients, commodities, or utilities.	
Medical Devices and Equipment	Sales and rentals of medical equipment, devices, and supplies (including hearing aids, dental prosthetic devices, eyeglasses, and blood glucose monitoring equipment) if prescribed by a licensed practitioner.	
Prescription Drugs	Legend drugs for humans or animals if sold by a registered pharmacist or licensed practitioner. Nonlegend drugs if dispensed upon original prescription or drug order and the user is confined to a hospital or health care facility. Insulin, oxygen, blood, and blood plasma if purchased for medical purposes.	
Property Directly Used in Providing Public Transportation	Property that is directly used or consumed in providing public transportation for persons or property.	
Property Purchased by Telecommunications Service Providers	Property purchased to furnish intrastate telecommunication service, video services or Internet access services, or VOIP services.	

Tax Provision	Description	Tax Incentive
Recycling Inputs	Machinery, tools, and equipment acquired for direct use in the direct processing of recycling materials by a person who is occupationally engaged in recycling.	
Required Pollution Abatement Equipment	Tangible personal property used for complying with any state, local, or federal environmental quality statutes, regulations, or standards. Purchaser must be engaged in the business of manufacturing, processing, refining, mining, recycling, or agriculture.	
Research and Development Property	Tangible personal property that has not previously been used in Indiana for any purpose and is acquired for the purpose of experimental laboratory research and development for new products, new uses of existing products, or improving or testing existing products.	X
Sales by a Utility Used in Manufacturing	Electrical energy, natural or artificial gas, water, steam, and steam heat acquired for direct consumption in the direct production of other tangible personal property.	
Sales by Charitable/Religious/Scientific/Educational Orgs.	Sales by a religious, charitable, scientific, literary, educational, civic, or other not-for-profit organization. Any purchase made by one of these organizations that is used to carry on or raise money to carry on its not-for-profit purpose.	
Sales by Fraternities/Sororities/Student Cooperative Housing Orgs.	Sales of meals by fraternities, sororities, and student cooperative housing organizations. All purchases by these organizations to carry on their ordinary and usual activities and operations.	
Type II Gambling Games	Includes pull tab, punchboard, and tip board games.	

Property Tax

Tax Provision	Description	Tax Incentive
Aircraft Deduction	Aircraft that seat up to ninety passengers or that are used to transport only property. The aircraft must be owned by a taxpayer with an Indiana corporate headquarters or its subsidiary. The deduction equals 100% of the property's AV.	X
Blind Deduction	Real property or mobile home residence of a blind individual with a $17,000 income cap. The deduction equals $12,480 AV.	
Brownfield Revitalization Zone Deduction	The designating body may grant a 3-, 6-, or 10-year abatement for real and personal property located in a brownfield revitalization zone. The deduction equals the increase in the property's AV multiplied by a percentage based on year and duration.	X
Cemetery Exemption	Tangible property is exempt if it is owned by a cemetery corporation, firm, or association which is organized under Indiana law.	
Certified Technology Park Deduction	Personal property located in a certified technology park and used to conduct high-technology activity. The deduction equals 100% of the property’s AV. The term of two to ten years is determined by the county fiscal body.	X
Charitable Exemption	All or part of a building, land, and related personal property is exempt if it is owned, occupied, and used for charitable purposes.	
Circuit Breaker Credit	Taxpayers are entitled to a credit if the net tax due on the property exceeds the tax cap applicable to their property. The credit is equal to the excess tax over a percentage of gross AV as follows: 1% for homesteads, 2% for all other residential property, commercial apartments, and farmland; 3% for all other real and personal property.	
Circuit Breaker Credit - Age 65 and Over	Qualifying seniors receive a credit if (1) their homestead AV is less than $160,000, (2) their income does not exceed $30,000 ($40,000, if married), and (3) the year-to-year increase in net tax on the homestead, after all other credits, exceeds 2%. The credit equals the tax that exceeds the 2% increase.	
Coal Combustion Product Deduction	Building designed and constructed to use qualified materials throughout the building. Qualified materials must consist of at least 60% coal combustion products by weight. The deduction is available for three years and equals 5% of the building’s AV.	X

Tax Provision	Description	Tax Incentive
Deduction for Purchases of Investment Property by Manufacturers of Recycled Components	Personal property used to manufacture recycled components composed of at least 15% coal combustion waste generated in Indiana. The deduction equals 15% of the investment property's AV only in the first year that the investment property is subject to assessment.	X
Disabled Deduction	Real property or mobile home residence of a disabled individual with a $17,000 income cap. The deduction equals $12,480 AV.	
Educational Exemption	All or part of a building, land, and related personal property is exempt if it is owned, occupied, and used for educational purposes.	
Enterprise Zone Investment Deduction	Qualified investments including buildings, manufacturing or production equipment, retooling, and infrastructure within an enterprise zone. The deduction equals the increase in AV of the enterprise zone property as compared to the AV in the base year.	X
Enterprise Zone Obsolescence Deduction (Marion County)	Newly purchased real property in an enterprise zone in Marion County if an obsolescence depreciation adjustment was allowed for the property in the year preceding the year in which the owner purchased the property. The deduction equals the amount of the former owner's obsolescence adjustment multiplied by 100% in year one, 75% in year two, 50% in year three, and 25% in year four.	X
Fine Arts Exemption	Tangible property is exempt if it is owned by an Indiana not-for-profit corporation which is organized and operated for the primary purpose of coordinating, promoting, encouraging, housing, or providing financial support to activities in the field of fine arts.	
Fraternity/Sorority Exemption	Land, improvements, and personal property is exempt if it is owned by a fraternity or sorority that is exempt from federal income taxation.	
Geothermal Energy Heating or Cooling Device Deduction	Real property or mobile home equipped with geothermal heating, cooling, hot water, or electricity production. The deduction equals the device's AV.	X
Homestead Credit - COIT	Counties that adopt the County Option Income Tax (COIT) may provide up to 8% in additional homestead credits paid from COIT revenues. The 8% maximum rate is adjustable to negate the effects of using only operating funds as a base for calculation.	

Tax Provision	Description	Tax Incentive
Homestead Credit - LOIT	Counties may provide additional credits to homesteads, residential property, all property, or any combination thereof from the proceeds of a local option income tax (LOIT) rate of up to 1%.	
Homestead or Residential Credit (Inventory Mitigation) - CEDIT	Counties may provide additional homestead or residential credits to offset the shift from the inventory exemption. These credits are funded from the County Economic Development Income Tax (CEDIT).	
Hospital Exemption	Tangible property is exempt from property taxation if it is owned by an Indiana nonprofit corporation and used in the operation of a hospital, a health facility, a residential facility for the aged, or a Christian Science home or sanatorium.	
Hydroelectric Power Device Deduction	Real property or mobile home equipped with a hydroelectric power device. The deduction equals the device's AV.	X
Industrial Waste Control Facility Exemption	Personal property is exempt if it is a part of or an adjunct to a privately owned manufacturing or industrial plant or coal mining operation; and used predominantly to (A) prevent, control, reduce, or eliminate pollution of a body of water by treating, pretreating, stabilizing, isolating, collecting, holding, controlling, or disposing of waste or contaminants generated by the plant; or (B) meet state or federal reclamation standards for a coal mining operation.	
Infrastructure Development Zone Deduction	Gas storage, transmission, and distribution facilities; broadband and advanced service transmission facilities; and water treatment, storage, and distribution facilities in an infrastructure development zone. Eligible property in the zone is 100% exempt.	X
Intrastate Aircraft Deduction	Aircraft used for service between qualifying Indiana airports that seat at least nine passengers or that are used to transport only property. The deduction equals 100% of the property's AV.	X
Lake/Reservoir Exemption	Land in Carroll and White Counties is exempt if (1) it is owned by a nonprofit public benefit corporation, (2) it is under or adjacent to a lake or reservoir, and (3) the lake or reservoir was formed by a dam or control structure owned and operated by a public utility for the generation of hydroelectric power.	
Literary Exemption	All or part of a building, land, and related personal property is exempt if it is owned, occupied, and used for literary purposes.	
LOIT PTRC - All Property	Property tax replacement credits for all real and personal property. See Description for Homestead Credit - LOIT	

Tax Provision	Description	Tax Incentive
Low-Income Elderly Deduction	Real property or mobile home residence of persons at least 65 years old with a $25,000 household income cap and a $182,430 AV cap. Surviving spouses qualify if at least 60 years old. The deduction equals $12,480 AV (limited to 50% of AV).	
Low-Income Housing Exemption	All or part of real property is exempt from property taxation if (1) the improvements on the real property were constructed, rehabilitated, or acquired for the purpose of providing housing to income-eligible persons, (2) the property is subject to an extended use agreement, and (3) the property owner has entered into an agreement to make payments in lieu of taxes.	X
Low-Income Residence Exemption	Land plus all or part of a structure on the land is exempt from property taxation if the land is acquired for the purpose of erecting, renovating, or improving a single-family residential structure that is to be given away or sold in a charitable manner by a nonprofit organization to low-income individuals who will use the land as a family residence.	
Marine Opportunity District Deduction	New manufacturing equipment installed in a maritime opportunity district. The deduction equals 100% of AV in years 1 to 6; 95% in year 7, 80% in year 8, 65% in year 9, and 50% in year 10. The deduction may not reduce a taxpayer's total personal property net assessment in the first year below the previous year's net assessment. The deduction is subject to approval by Ports of Indiana.	X
Mortgage Deduction	Mortgaged real property or mobile home. The deduction equals $3,000 AV (limited to 50% of AV and the amount of mortgage balance).	
Personal Property Abatements in an Economic Revitalization Area	New manufacturing, research and development, logistical distribution, and information technology equipment located in an economic revitalization area. The local designating body determines the length of the deduction from 1-10 years. The designating body must specify an abatement schedule.	X
Pollution Control Personal Property Exemption	Personal property is exempt from property taxation if it is part of a stationary or unlicensed mobile air pollution control system of a private manufacturing, fabricating, assembling, extracting, mining, processing, generating, refining, or other industrial facility; and is acquired for the purpose of complying with environmental quality statutes, regulations, or standards.	

Tax Provision	Description	Tax Incentive
Real Property Abatements in an Economic Revitalization Area	Improvements made to real property located in an economic revitalization area. The local designating body determines the length of the deduction from 1-10 years. The designating body must specify an abatement schedule.	X
Rehabilitated Property Deduction	Buildings and structures at least 50 years old if the owner paid at least $10,000 for the rehabilitation. The deduction is available for five years and equals 50% of the increase in AV (limited to $124,800 for a single-family dwelling or $300,000 for other property).	X
Rehabilitated Residential Property Deduction	Residential real property that has been rehabilitated. The pre-rehabilitation AV may not exceed $37,440 for a single-family dwelling, $49,920 for a two-family dwelling, or $18,720 per unit if more than two dwelling units. The deduction is available for five years and equals the increase in AV (limited to $18,720 per rehabilitated unit).	X
Religious Exemption	All or part of a building, land, and related personal property is exempt if it is owned, occupied, and used for religious purposes.	
Residential Credit - LOIT	Property tax credits for all residential real property (homesteads and nonhomesteads). See Description for Homestead Credit - LOIT	
Resource Recovery Systems Deduction	Tangible property directly used to dispose of solid waste or hazardous waste by converting it into energy or other useful products. The deduction equals 95% of the system's AV. This deduction currently applies to only one property, located in Marion County.	X
Resource Recovery/Coal or Oil Shale System Deduction	Tangible property used to convert coal into a gaseous liquid fuel or charcoal. The deduction equals 95% of the system's AV multiplied by the fraction (Indiana Coal Converted/Total Coal converted).	X
Scientific Exemption	All or part of a building, land, and related personal property is exempt if it is owned, occupied, and used for scientific purposes.	
Service-Connected Disabled Veterans Deduction	Real or personal property of wartime veteran with at least a 10% service-connected disability or their survivor. The deduction equals $24,960 AV.	
Solar-Energy Systems Deduction	Real property or mobile home equipped with solar energy heating or cooling system. The deduction equals system's cost.	X

Tax Provision	Description	Tax Incentive
Specified Organization Exemption	Tangible property is exempt if it is owned by any of the following organizations: (1) the YMCA, (2) the Salvation Army, (3) the Knights of Columbus, (4) the YMHA, (5) the YWCA, (6) the Disabled American Veterans of World War I or II, (7) the VFW, (8) the American Legion, (9) the American War Veterans, (10) the Boy Scouts, or (11) the Girl Scouts.	
Spouse of World War I Veteran Deduction	Real or personal property of surviving spouse of a World War I veteran. The deduction equals $18,270 AV.	
Standard Deduction	Owner-occupied primary residence, including up to one acre of land. The deduction equals $45,000 AV (limited to 60% of AV).	
Supplemental Standard Deduction	Automatic for those who receive the standard deduction. It applies to net AV after the standard deduction. The deduction equals 35% of first $600,000 net AV plus 25% of net AV over $600,000.	
Totally Disabled Veterans Deduction	Real or personal property of veteran with a total disability (or at least 10% disability if age 62 or over) or their survivor. There is a $143,160 AV cap. The deduction equals $12,480 AV.	
Veteran of World War I Deduction	Residential real property of World War I veteran with a $206,500 AV cap. The deduction equals $18,270 AV.	
Wind-Power Devices Deduction	Real property or mobile home equipped with wind power equipment designed to provide mechanical energy or produce electricity. The deduction equals the device's AV.	X

Other

Tax Provision	Description	Tax Incentive
Certified Technology Park	Special zones established by local units that capture state and local tax revenue for high-technology business development in the zones.	X
Community Revitalization Enhancement Districts	Special district established by local units that may capture state and local tax revenue development purposes in the districts.	X
Depreciation Deduction for Certain Resource Recovery Systems (Utility Receipts Tax)	Equal to the federal depreciation deduction for a resource recovery system that processes solid waste or hazardous waste.	
Enterprise Zones	Special zone established by municipalities units where tax incentives are provided for development in the zones.	X
Lower Rates for Smaller Riverboats	Special lower wagering tax rates for riverboat casinos that generate less than $75 million in annual gross revenue.	X
Motorsports Investment District	Geographic area including the Indianapolis Motor Speedway. Revenue is captured from certain incremental sales tax, individual income tax, and admissions fee revenue.	X
Professional Sports Development Areas	Special areas established by local units that may capture state and local tax revenue for sports and convention development purposes in the areas.	X
Promotional Free Play Deduction	Wagering tax deduction for wagers made by casino patrons using noncashable vouchers, coupons, electronic credits, or electronic promotions provided by the casino.	X
Tax Increment Financing	Special district established by local units that capture incremental property tax revenue for development purposes in the districts.	X

Appendix 3 - State Revenue Loss from Individual Income Tax Incentive and Nonincentive Provisions

Tax Provision	In Millions	
	FY 2016	FY 2017
21st Century Scholars Program Credit	*	*
Adoption Tax Credit	$0.4	$0.4
Alternative Fuel Vehicle Manufacturing Investment Credit	*	*
Civil Service Annuity Income Deduction	$0.3	$0.3
Coal Gasification Technology Investment Credit	*	*
Community Revitalization Enhancement District Credit	$0.7	$0.7
Deduction for Human Services Recipients	$1.1	$1.3
Dependent Child Exemption	$86.4	$87.6
Dependent Exemption	$69.0	$69.7
Disability Retirement Income Deduction	$0.2	$0.2
Earned Income Tax Credit	$83.3	$79.8
Economic Development for a Growing Economy (EDGE) Credit	$2.6	$2.7
Elderly/Blind Exemption	$26.1	$26.6
Enterprise Zone Employee Income Deduction	$0.8	$0.7
Enterprise Zone Employment Expense Credit	$0.5	$0.5
Enterprise Zone Investment Cost Credit	$0.1	$0.1
Enterprise Zone Loan Interest Credit	*	*
Headquarters Relocation Credit	*	*
Historic Rehabilitation Credit	$0.2	$0.2
Home Insulation Deduction	$1.1	$1.1
Homeowner's Property Tax Deduction	$53.2	$53.2
Hoosier Business Investment Credit	$1.1	$1.1
Hoosier Lottery Winnings Deduction	$0.9	$0.9
Indiana 529 College Savings Account Contribution Credit	$61.4	$67.6
Indiana Colleges and Universities Contribution Credit	$8.6	$8.7
Indiana Partnership Long-Term Care Ins. Premiums Deduction	$1.6	$1.7
Individual Development Accounts Credit	*	*
Industrial Recovery Credit	$0.2	$0.2
Lake County Homeowner's Property Tax Credit	$0.0	$0.0
Law Enforcement Rewards Deduction	*	*
Low-Income Elderly Exemption	$7.3	$7.3
Medical Savings Account Contributions Deduction	$0.1	$0.1
Military Service Income Deduction	$9.1	$9.1
National Guard and Reserve Member Deduction	$1.8	$1.9
Natural Gas-Powered Vehicles Credit	$0.7	$0.7

Tax Provision	In Millions FY 2016	FY 2017
Neighborhood Assistance Credit	$2.1	$2.1
Net Operating Losses Deduction	$24.1	$24.1
Patent-Derived Income Deduction	*	*
Personal Exemption	$143.4	$144.9
Private School/Home School Expenses Deduction	$3.4	$3.6
Railroad Retirement Income Deduction	$4.3	$4.4
Railroad Unemployment and Sickness Benefit Deduction	$0.1	$0.1
Renter's Deduction	$60.8	$60.9
Research Expense Credit	$16.8	$17.5
Residential Historic Rehabilitation Credit	$0.2	$0.2
School Scholarship Contribution Credit	$4.0	$5.0
Social Security Benefits Deduction	$177.3	$188.9
Solar Powered Roof Vent/Fan Installation Deduction	*	*
Special Rate for Income Derived Inside a Military Base	*	*
Unemployment Compensation Deduction	$16.0	$16.2
Unified Tax Credit for Elderly	$11.3	$11.2
Venture Capital Investment Credit	$3.8	$4.0

*Revenue loss is less than $100,000.

Appendix 4 – State Revenue Loss from Corporate Income Tax Incentive and Nonincentive Provisions

	In Millions	
Tax Provision	**FY 2016**	**FY 2017**
21st Century Scholars Program Credit	*	*
Alternative Fuel Vehicle Manufacturing Investment Credit	*	*
Coal Gasification Technology Investment Credit	$15.0	$15.0
Community Revitalization Enhancement District Credit	$0.8	$0.8
Economic Development for a Growing Economy (EDGE) Credit	$69.4	$70.6
Enterprise Zone Employment Expense Credit	$0.8	$0.8
Enterprise Zone Investment Cost Credit	*	*
Enterprise Zone Loan Interest Credit	$1.9	$1.9
Headquarters Relocation Credit	*	*
Historic Rehabilitation Credit	*	*
Hoosier Business Investment Credit	$7.3	$7.5
Indiana Colleges and Universities Contribution Credit	*	*
Individual Development Accounts Credit	*	*
Industrial Recovery Credit	$0.4	$0.4
Natural Gas-Powered Vehicles Credit	*	*
Neighborhood Assistance Credit	*	*
Net Operating Losses Deduction	$121.2	$109.1
Patent-Derived Income Deduction	*	*
Research Expense Credit	$55.5	$57.9
School Scholarship Contribution Credit	*	*
Special Rate for Income Derived Inside a Military Base	*	*
Venture Capital Investment Credit	*	*

*Revenue loss is less than $100,000.

Appendix 5 – State Revenue Loss from Sales Tax Incentive and Nonincentive Provisions

Tax Provision	In Millions FY 2016	FY 2017
Aircraft parts	$4.7	$4.9
Aviation fuel	$7.9	$8.2
Cargo trailers/RVs sold to certain nonresidents	$1.4	$1.4
Certain aircraft	$21.3	$22.0
Certain racing equipment	$5.5	$5.5
Computer equipment sold by schools to parents	$0.5	$0.5
Food for at-home human consumption	$762	$773
Lottery tickets	$66.6	$67.5
Medical devices and equipment	$90.4	$94.8
Manufacturing, farming, and public utility production inputs		
Goods directly used in direct production of food, food ingredients, and commodities	$61.3	$62.0
Goods directly used in direct production of manufactured goods	$1,679.9	$1,718.3
Goods directly used in direct production of public utilities	$66.8	$67.9
Prescription drugs	$440.7	$462.5
Property directly used in providing public transportation	$69.8	$72.1
Property purchased by telecomm. Service providers	$10.5	$10.5
Recycling inputs	$3.8	$3.9
Required pollution abatement equipment	$8.2	$8.7
Research and development property	$6.7	$7.0
Sales by a utility used in manufacturing, etc.	$41.8	$42.7
Sales by charitable/religious/scientific/educational orgs.	$19.9	$20.4
Sales by fraternities, sororities, and student cooperative housing organizations	*	*
Type II gambling games	$0.3	$0.3

*Revenue loss is less than $100,000.

Appendix 6 – State Revenue Loss from Other Tax Incentive Provisions

Tax Provision	In Millions FY 2016	FY 2017
Certified Technology Parks	$2.4	$2.1
Community Revitalization Enhancement Districts	$5.0	$5.1
Lower Rates for Smaller Riverboats	$5.7	$5.7
Motorsports Investment District	$5.0	$5.0
Professional Sports Development Areas	$26.8	$27.2
Promotional Free Play Deduction	$15.3	$0.0

Appendix 7 – Local Option Income Tax Revenue Loss from Individual Income Tax Incentive and Nonincentive Provisions

Tax Provision	In Millions FY 2016	FY 2017
Civil Service Annuity Income Deduction	$0.1	$0.1
Community Revitalization Enhancement District Credit (Local)	*	*
County Credit for the Elderly or Permanently Disabled	*	*
Deduction for Human Services Recipients	$0.5	$0.5
Dependent Child Exemption	$36.7	$37.2
Dependent Exemption	$29.3	$29.6
Disability Retirement Income Deduction	$0.1	$0.1
Elderly/Blind Exemption	$11.1	$11.3
Enterprise Zone Employee Income Deduction	$0.3	$0.3
Home Insulation Deduction	$0.5	$0.5
Homeowner's Property Tax Deduction	$22.6	$22.6
Hoosier Lottery Winnings Deduction	$0.4	$0.4
Indiana Partnership Long-Term Care Ins. Premiums Deduction	$0.7	$0.7
Law Enforcement Rewards Deduction	*	*
Low-Income Elderly Exemption	$3.1	$3.1
Medical Savings Account Contributions Deduction	*	*
Military Service Income Deduction	$3.8	$3.9
National Guard and Reserve Member Deduction	$0.8	$0.8
Net Operating Losses Deduction	$10.2	$10.2
Patent-Derived Income Deduction	*	*
Personal Exemption	$60.8	$61.5
Private School/Home School Expenses Deduction	$1.5	$1.5
Railroad Retirement Income Deduction	$1.8	$1.9
Railroad Unemployment and Sickness Benefit Deduction	*	*
Renter’s Deduction	$25.8	$25.8
Social Security Benefits Deduction	$75.2	$80.1
Solar-Powered Roof Vent/Fan Installation Deduction	*	*
Unemployment Compensation Deduction	$6.8	$6.9

*Revenue loss is less than $100,000.

APPENDIX 8 - Local Revenue Loss from Other Tax Incentive Provisions

Tax Provision	FY 2016	FY 2017
	In Millions	
Certified Technology Parks	$0.7	$0.6
Community Revitalization Enhancement Districts	$0.6	$0.6
Professional Sports Development Areas	$3.1	$3.1
Lower Rates for Smaller Riverboats	$1.8	$1.8
Promotional Free Play Deduction	$5.2	$0.0

APPENDIX 9 - Local Property Tax Revenue Change from Tax Incentive and Nonincentive Provisions

	In Millions	
Incentive Provision	**CY 2015***	**CY 2016***
Hydroelectric Power/Geothermal Energy Heating/Cooling Deductions	-$0.72	-$0.74
Enterprise Zone Personal Property Deduction	-2.70	-2.92
Enterprise Zone Real Property Deduction	-3.63	-3.74
Personal Property Abatements	-39.20	-39.81
Real Property Abatements	-30.98	-31.58
Rehabilitated Property Deduction	-0.05	-0.05
Rehabilitated Residential Property Deduction	-0.10	-0.08
Solar Energy Systems/Wind-Powered Devices Deductions	-0.14	-0.14
Low-Income Housing Exemption	-1.25	-1.35
Total Incentives	**-$78.87**	**-$79.92**
Nonincentive Provision		
Blind Deduction	-$1.15	-$1.17
Disabled Deduction	-5.76	-5.75
Low-Income Elderly Deduction	-10.65	-10.95
Mortgage Deduction	-20.08	-20.24
Service-Connected Disabled Veterans Deduction	-9.68	-9.86
Standard and Supplemental Standard Deductions	256.59	257.53
Supplemental Standard Deduction	33.80	34.07
Totally Disabled Veterans Deduction	-2.10	-2.07
Cemetery Exemption	-3.13	-3.13
Charitable Exemption	-73.12	-75.17
Education Exemption	-50.82	-52.49
Fine Arts Exemption	-1.01	-1.11
Fraternity/Sorority Exemption	-2.60	-2.77
Hospital Exemption	-45.29	-46.83
Lake/Reservoir Exemption	-0.09	-0.10
Literary Exemption	-1.10	-1.12
Low-Income Residence Exemption	-0.06	-0.08
Religious Exemption	-101.35	-103.59
Scientific Exemption	-0.15	-0.15
Specified Organization Exemption	-16.21	-16.44
Total Nonincentives	**$20.95**	**$17.22**
Total Incentives and Nonincentives	**-$55.18**	**-$60.73**

Credits	CY 2015*	CY 2016*
Total Local LOIT-Funded Credits	$143.61	$148.22
Circuit Breaker Credit	-820.23	-850.14
Circuit Breaker Credit - Age 65 and Over	-4.74	-4.90
Total Credits	**-$681.37**	**-$706.82**

*Calendar year total for each provision is revenue change attributable to circuit breakers, cumulative/ referendum fund levies, and TIF gross revenue.

APPENDIX 10 - Input-Output (I-O) Models

Input-Output (I-O) models are mathematical representations that describe the movements of goods and services between industries, households, and governments. They seek to account for all monetary transactions among industries and between industries and final consumers for a specific period of time. I-O models accomplish this through inter-industry transaction matrices, industry-specific multipliers, and other structural coefficients that represent relationships between the different sectors. Together, these components provide a detailed representation of a region's industrial structure and provide a tool to examine how changes in one or more sectors of the economy affect other sectors.

I-O models do have limitations. I-O models trace the flow of dollars in the economy, so the activity of interest must be described in terms of sales, purchases, or expenditures. These models cannot be used to measure social or political changes.[49] Because I-O models express the inputs and outputs strictly in dollars, the models do not consider variations in the types of products. I-O models assume each industry is producing a homogenous product.[50] For example, if a business orders $1 million in laptops and $2 million in network servers the model will treat both purchases as simply computer products. Consequently, the I-O model will only trace the impact of a $3 million sale of computers. In addition, I-O models are not well suited for forecasting. The underlying mathematical data that describe the relationships between sectors are snapshots in time, so they may not be relevant in the future.[51]

The I-O models used to estimate the economic impact of tax incentives in this report were developed using the IMPLAN system. The IMPLAN system is a regional I-O modeling software application developed in 1979.[52] The application and the IMPLAN datasets allow us to build Indiana specific regional I-O models. While the IMPLAN models all have different parameters, inputs, and assumptions, our results are displayed in a similar format.

Activity		**$737,761**	
First round of spending leaving the state		**$179,495**	
Economic Impact from ….	**Employment**	**Labor Income**	**Output**
The activity directly	3.3	$172,950	$516,679
Inter-industry spending through the supply chain	1.4	$64,316	$185,117
Local spending of wages & salaries	1.5	$56,962	$172,861
Total Impact	**6.2**	**$294,228**	**$874,657**

The first row of the table reports the spending *activity* the model is measuring. This is the starting point for the I-O model. The activity is expressed as the sum of all the sales or expenditures of the sectors that are directly experiencing the change. The activity in our example is the home insulation project expenditures made by homeowners.

Some of the goods and services will likely need to be imported to meet the demand of the activity. For example, a wholesaler may not be able to purchase all of the windows needed to fulfill an order from an

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[49] Day, Francis. Principles of Impact Analysis and IMPLAN Application. First Edition. IMPLAN Group, LLC, www.IMPLAN.com.
[50] Popp, Anthony V. and C. Meghan Starbuck. (2009). The Economic Impact of Exempting Retired Military Service Payments from New Mexico Personal Income Tax. Arrowhead Center, New Mexico State University. January 25, 2009.
[51] Day, Francis. Principles of Impact Analysis and IMPLAN Application. First Edition. IMPLAN Group, LLC, www.IMPLAN.com.
[52] ibid.

Indiana manufacturer, nor will an Indiana window manufacturer be able to purchase all the necessary lumber locally. They may have to purchase products from outside the region. The cost of the imported goods or spending outside the state is the *first round of spending leaving the state* which is reported in the second row of the table. This is also referred to as leakage. This row only shows the first round of leakage. The models will normally not show the leakage associated with subsequent rounds of inter-industry or labor spending.

The model shows the economic impact of the activity using three metrics: employment, labor income, and output. Employment is the total number annual average jobs. It includes self-employed individuals, salary and wage employees, and all full-time, part-time and seasonal jobs. Labor income is comprised of wages and benefits paid to the employees and profits earned by self-employed individuals. Output is the total value of an industry's production. It includes labor income along with all the purchases of the intermediate goods, payments to government, and other property income.[53]

The economic impact from *the activity directly* is reported in the fourth row of the table. In the home insulation project example, this line has the employment, labor income, and output of the contractors, wholesalers, insulation manufacturers, and window manufacturers attributable to the spending on home insulation projects. These are also known as direct impacts. According to the model, $737,761 in home insulation project expenditures by Indiana homeowners is estimated to generate 3.3 additional jobs, $172,950 in additional labor income, and $516,679 in additional output in those industries directly affected by the home insulation projects. These direct transactions trigger both inter-industry spending throughout the supply chain and local spending of wages and salaries.

To meet the demand of the activity, businesses will have to purchase commodities to produce their own products. The economic impact of the *inter-industry spending through the supply chain* is reported in the fifth row of the table. In the example, a window manufacturer will purchase wood, glass, utilities, and other goods to make the windows to sell to the homeowner. As a result, a homeowner buying windows is also stimulating the glass, wood, and other industries that make goods for the window manufacturer. The estimated impact of those supply chain purchases is 1.4 jobs, $64,316 in labor income, and $185,117 in output. These employment, income, and output impacts are also referred to as indirect impacts because they are stimulated by the increase in sales in another industry.

The expenditures associated with the industries experiencing the activity and the inter-industry spending through the supply chain most often result in changes in employment. These employees receive wages, salaries, and other forms of income that they spend on goods and services generally where they reside. The *local spending of wages & salaries* is reported in the sixth row of the table and is an estimate of the spending impact by these employees. This is referred to as the induced impact. According to the example, the employees affected by home insulation project expenditures will spend their wages and salaries locally. It’s estimated that this spending will generate 1.5 jobs, $56,962 in labor income, and $172,861 in output. The measurement of the labor income spending is limited to the study region - Indiana. If the employees live outside the region, the spending is not included.

The bottom row of the table reports the total economic impact for employment, labor income, and output. Because labor income is a component of output, those two metrics should not be added together.

[53] Day, Francis. Principles of Impact Analysis and IMPLAN Application. First Edition. IMPLAN Group, LLC, www.IMPLAN.com.