Property Tax Relief Analysis

White Paper

Prepared by: Hobbs Ong & Associates

Property Tax Relief Analysis

Introduction

The events in the Nevada real estate market over the past 18 months have led to unprecedented gains in the value of real property (see Exhibit 1). This has been particularly true in Southern Nevada (see Exhibit 2). The gains in value over this period can be tied to several factors including low interest rates, supply/demand dynamics, and a significant influx of out-of-state investment interest.

These gains in value have provided many property owners with substantial increases in their equity. At the same time, however, the value of their property for purposes of taxation has also increased. While there is no question that the gains in equity have greatly outpaced the increases in ad valorem (property) tax liability, concerns about the increases in tax liability have prompted an outcry from property owners and has resulted in a litany of ideas as to how to manage these increases.

Exhibit 1
Housing Price Appreciation
State of Nevada

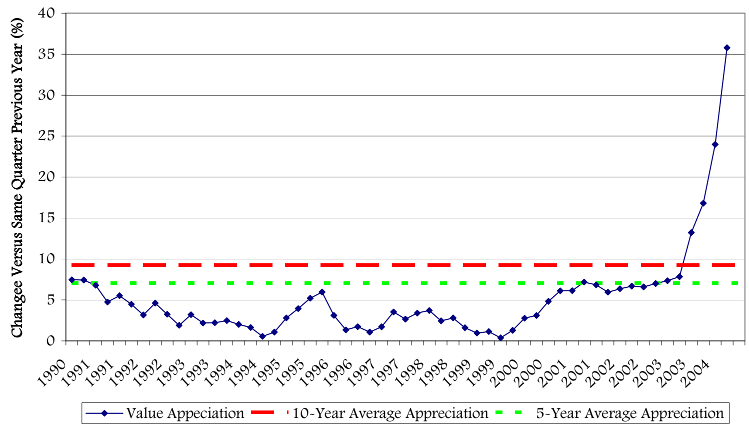
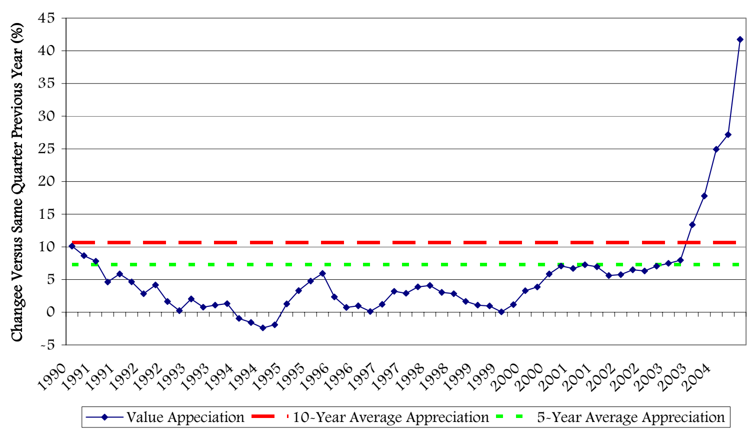


Exhibit 2
Housing Price Appreciation
Las Vegas Metropolitian Area



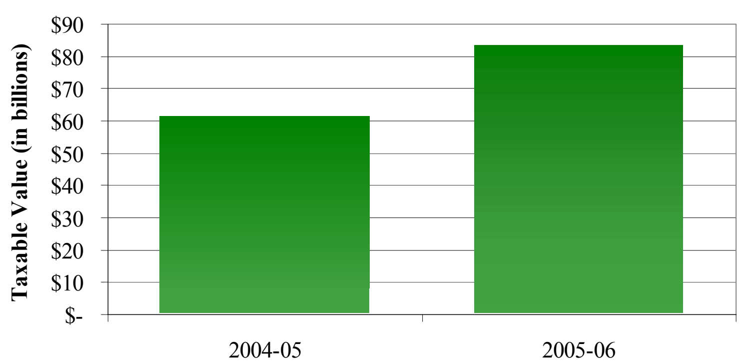
In addition to the concerns on the part of taxpayers, it should be understood that the unprecedented gain in assessed valuation is also abnormal from a government perspective. That is, government units that rely upon property tax revenues to fund basic services have come to rely upon a somewhat predictable rate of growth over the past several years. These historic growth rates are used from year to year to estimate the amount of revenue that is expected to materialize from a "normal" rate of growth in valuation. To the extent that the growth in assessed valuation is expected to greatly exceed the otherwise "normal" rates of growth, unexpected levels of revenue would result. This, despite opinions to the contrary, creates concern for government. Simply put, government needs growth in revenue to provide essential and basic services for a growing populace. It does not need unexpected gains to fund predictable needs. This being said, however, government also needs its growth in basic revenues to be both predictable and sufficient. Sufficiency, of course, is a matter of opinion.

There is no question that the recent aberration in the growth of property values, from the standpoint of the bottom line tax bill, will need to be mitigated. This is in part due to the level of increases that would otherwise befall the taxpayer, and in part because government would not have counted on such large scale increases in revenues in planning or budgeting for the provision of basic governmental services.

A recurring theme in any method of mitigation discussed in this analysis will be the level of permitted or needed growth in revenue from year to year. This is an exceptionally important point. Whether the method of mitigation centers upon a tax bill "freeze", exemptions/exclusions, or capping mechanisms, the amount of property tax revenue growth that is to be allowed from year to year becomes a common denominator in fashioning a solution. The solution has to work for both the taxpayer and the units of government that provide services to the taxpayer. Too little relief or protection for the taxpayer will result in the generation of revenue beyond the needs of government, not to mention ongoing taxpayer discontent. On the other hand, over-constraining the level of revenue growth from year to year could affect the delivery of basic services and place government in the position of having to seek new and perhaps less palatable sources of revenue.

The fact is that property values – prior to the huge increases experienced over the past year – have historically grown from year to year (see Exhibit 3). As property owners, this is what we hope for when we invest in real estate. Excluding new property that comes on the tax rolls from year to year, property that existed on the previous year's tax rolls has generally increased in value. Although on a parcel-to-parcel basis the growth rates varied, in aggregate the growth rate had a central tendency of approximately six percent per year. That is, it has been "normal" for property to increase in aggregate value at a rate of six percent per year. Lesser growth than this in the future would be below historic norms. More growth than this – such as is expected over the coming tax year – would be greater than historic norms.

Exhibit 3
Increases in Taxable Property Value

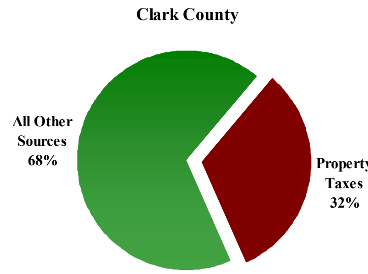


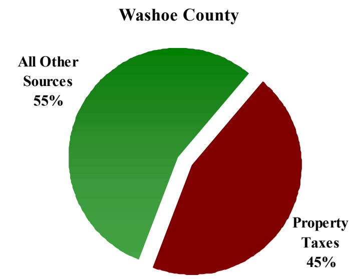
Property tax revenue in Nevada funds a significant portion of State and local governmental services. At the local county and city levels, property tax revenues generally make up between 20 and 40 percent of the total general fund revenue base (see exhibits on the following page). Local governments have come to rely on both the revenue produced and the predictability of the revenue. In many ways, property tax revenue acts as a hedge against the long-term volatility of other primary revenue sources (such as sales tax).

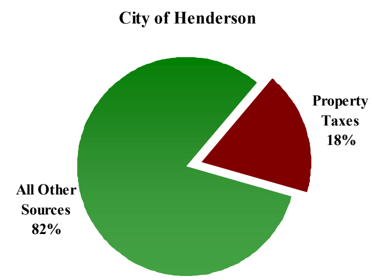
Property tax revenues also fund a significant portion of the cost of public education. In fact, the largest single segment of the combined property tax rates throughout the State is levied in support of the funding of K-12 education – including both operations and capital. Thus, it can be safely said that the future of property tax revenue and the funding of education (as well as other State and local services) are intrinsically linked. Education is used as an example because it is a public service that has come under substantial recent criticism as an area that may not be appropriately funded. The point here is that we are talking about a crucial revenue source when we talk about property tax revenue. Extreme care and thoughtfulness must be exercised when modifications to the system are considered.

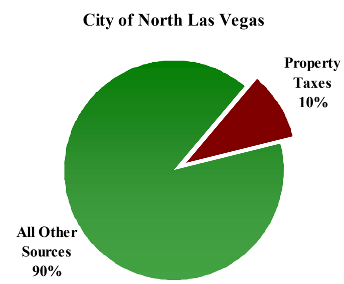
While this paper does not include an exploration of the causes of the increases in property values, this is a very worthy topic that may also lead to a better understanding of the causal factors and lead one toward a more properly targeted solution. This would be extremely beneficial to explore as it may lead to a better understanding of whether we are dealing with a short-term aberration or a longer-term systemic problem. Suffice it to say that the recent, rapid increase in property values is widely believed to be a market aberration. That is, the conditions that caused the surge in values are not expected to persist. In fact, we are seeing evidence that the real estate market has cooled dramatically, and we expect to see market values recede somewhat from their peaks. After this settling period, we expect property values to once again assume a normal growth pattern going forward.

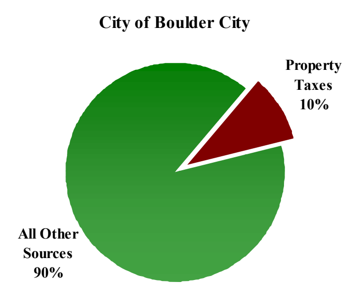
The solutions that one would fashion for a short-term aberration versus a long-term systemic problem are dramatically different. It is generally considered best to solve the problem at hand, as opposed to over-solving the problem and risking the incurrence of unforeseen consequences. In other words, it would be dangerous to attempt to make sweeping systemic changes to the assessment and tax regime to solve a problem founded in a short-term aberration.











Because of the general coalescing of viewpoints that mitigation of significant increases in tax liability is a priority, this paper will focus upon some of the relief mechanisms that have been suggested, or can otherwise be considered, and their underlying strengths and weaknesses.

Goals and Principles to Guide Property Tax Relief

As was noted above, the task at hand has been prompted less by concern with Nevada's overall system of appraising and taxing property than by concern as to the impact of a sudden aberration in values. Accordingly, it would seem that the immediate goal is to mitigate the spikes in tax liability that is associated with the spike in property values. This would suggest that sweeping systemic changes are not the goal and, given the relative stability of Nevada's taxation system over the years, broad and sweeping changes may create more uncertainty than relief.

Even with short-term mitigation measures, there are certain goals and principles that should be kept in mind while attempting to fashion a solution. Among these would be that any change to the method of arriving at a modified tax bill:

- Fit within Nevada's Constitutional framework
- Can be implemented no later than the end of March, 2005. This strongly suggests that the method of remediation be both simple and effective, and that it does not affect the basic manner in which property is assessed.
- Be administratively feasible
- Be easy for the taxpayer to comply with
- Be predictable, stable and sufficient as to revenue production
- Be as equitable as possible, both horizontally and vertically; that is, that the change be more progressive than regressive (i.e., providing relief where relief is most needed), and that the change treat similarly-situated taxpayers similarly
- Be as transparent to the taxpayer as possible – that is, be as easily understood by the taxpayer as possible
- Be as economically neutral as possible
- Be as flexible as possible in responding to changing conditions
- Not adversely impact the credit quality and bonding capacity of the State and units of local government

Any and all changes proposed should be measured by their conformance with the aforementioned goals and principles. Failure to give these goals and principles a prominent place in any discussions regarding a solution could lead to not only a less than optimal solution, but could create damage to one of the more essential taxation systems in the State.

The first bullet above notes that any solution will need to fit within the Constitutional framework of the State. This is the ultimate constraint. Any proposed solution – despite how well it may solve the problem at hand – must be found to be Constitutional. That is, that the tax system must be considered “equal and uniform”. This is somewhat a paradoxical matter as passing Constitutional muster may provide intended protection, but at the same time it may limit the solutions to less optimal choices. The best choices, however, should not be overlooked – even if they fail to currently pass Constitutional muster. Perhaps this limitation may lead to a near-term, Constitutional solution with a longer-term best solution (presuming modifications to the Constitution). This point should be given strong consideration, as we should ultimately strive for the best solution; not the next best solution that meets current limitations.

Put another way, we are currently trying to address this problem with the tools that our Constitution and law permit us to consider. Perhaps arriving at the best solution could be aided by having more tools to consider. We believe this to be the case.

The degree to which the several methods of proposed tax relief that are known at this time comply with these goals and principles will be measured later in this analysis.

Premises of Taxation of Real Property

As the reader is likely aware, property tax is levied by a series of overlapping units of government. For most taxpayers in the State, this would include the State, the county, the county school district, a city (if applicable), and special districts (if applicable). Taken from another angle, this would also include levies for the funding of operations and debt, and, in some cases, special purpose levies (voter approved tax overrides). Some of the levies noted above are fixed either in State statute or by virtue of the way the levy was initially imposed; they may also be variable.

In order to explore the issue of constraining property tax liability growth, one must have a clear understanding of the mathematics that produces the value that there is a desire to constrain – the tax bill. The variables that appear below, when combined with constants, produce the value of the tax bill:

A = Full cash value of the land
B = Replacement value of improvements that are situated on the land
C = Depreciation of the value of the improvements (B x .015 (1.5 percent) per year)
D = Combined tax rate for all overlapping taxing entities
E = Tax liability

The algebra that produces the tax bill is illustrated as follows:

$$((A + (B - C) \times .35) / \$100) \times D = E;$$

Where:

$B - C > \text{or} = .25 \times B$ (depreciation limitation);
$D < \text{or} = \$3.64$ (statutory rate cap);

D < or = \$5.00 (constitutional rate cap); and
A + (B – C) < market value (market value limitation)

By way of example, if a seven year-old property has a land value of \$100,000, and replacement value of improvements of \$125,000 and is situate in a taxing district with a combined tax rate of \$2.80, the tax bill can be computed as follows:

((\$100,000 + \$125,000 – (\$125,000 x 7 years x .015)) x .35 / \$100) x \$2.80 = E;
(\$211,875 x .35 / \$100) x \$2.80 = E;
(\$74,156.25/\$100) x \$2.80 = E;
\$741.5625 x \$2.80 = \$2,076.38

It should be noted that the two constants in the above equation represent statutory factors that are used to conform the equation to the current tax regime. The ".35" is known as the assessment ratio, which reduces the taxable value to assessed value. The "\$100" is intended to adjust the assessed value to an appropriate level to be applied to the tax rate (D). It is this constant that is responsible for the terminology "per \$100 of assessed valuation" that is commonly used when discussing property tax rates.

From an examination of the above, it can clearly be seen that any of the variables (and the two constants) to the left of the "=" sign have an effect upon the product to the right of the "=" sign. Thus, in theory, any of these values can be adjusted or modified to produce a different outcome to the right of the "=" sign. This being said, adjustment of certain variables or constants will produce other outcomes; some of which may be wholly undesirable in attempting to meet the goal of constraining the final product. This is the real purpose of this analysis – to explore where and how adjustments to the math can be made which both meet the goal and minimize undesirable outcomes.

Nevada is a State that uses a "synthesized" value to represent the value of property for purposes of taxation. In other words, as can be seen in the above equation, Nevada uses full cash value of land combined with the depreciated replacement value of improvements to land to represent the taxable value. This value – with the possible exception of the full cash value of the land -- has no direct relationship to the true market value of the property. Taxable value is, by virtue of the way improvements are appraised, generally less than market value. There is no re-basing of values or loss of depreciation upon the transfer of title.

There are also some procedural considerations that must be understood. Tax bills are required to be sent to taxpayers by the various county treasurers in the beginning of July of each year. Delays in the printing and mailing of the tax bills could create problems in meeting the first payment due date of the third Monday in August. Additionally, delays in printing and mailing the tax bills could present cash-flow problems for local governments and school districts. Because of the foregoing, it is essential that the solution be resolved and set into place in time as to not adversely affect the billing and payment dates. It is estimated that, if a solution can be set into place by the end of

March, there would be no adverse impact upon this schedule. If the solution were to take longer than this to be encoded into law, these dates would be at risk.

It is also important to bear in mind that solutions that may work for one county may not work for another. For example, Clark County reappraises property annually. The other 16 counties are on five year reappraisal cycles. Because only 20 percent of the properties within these other counties are physically revalued each year, any plan for relief must insure that the taxpayers in the entire county are treated fairly. It should also be stressed that the rapid growth in valuation of property is not something that has affected all Nevada counties in the same manner. Some, like Clark County, have experienced comparatively rapid growth. Others, including some of the rural counties, have not experienced growth at all. Finding a solution that achieves the desired result, while also proves to be equal and uniform as prescribed by the Constitution may become challenging.

We will attempt to explore each of the variables and constants noted in the equation above, focusing upon the relative strengths and weaknesses of modifications to each. It should be added that each of the potential solutions offered by elected leaders and other concerned parties address one or more of the variables in the tax bill equation. As a result, it is likely that the potential solutions and ideas that have come forth to date will be directly or indirectly addressed in the paragraphs that follow. Potential solutions that relate to variables or constants in the equation will be listed under each area of discussion.

Variable "A" – Land Value

The recent surges in taxable property values have been largely driven by dramatic increases in the value of land. As is discussed in the section that follows, the value of improvements to land is based upon replacement value (less depreciation), which is not subject to market value trends. Replacement value is more closely linked to inflationary effects that would impact the cost of materials and labor necessary to replace improvements. Thus, it is increases in land values, not the value of improvements to land, which has been central to the increases in taxable values. It is sensible, then, to focus upon this variable as a means to addressing the problem.

As previously noted, the full cash value of land is used for tax purposes in Nevada. The full cash value of the land is combined with the depreciated replacement value of improvements on the land to form the taxable value of the property. Limitations, or caps, can be placed upon the amount of increase in taxable value from year to year. Likewise, exclusions or exemptions can be used to reduce taxable value. On the surface, these may seem to be simple matters. However, when consideration is given to uniform treatment in all Nevada counties, the challenge emerges.

One thing that will be a recurring theme as each of the components of the tax bill equation is explored is the level of aggregate tax relief needed or, conversely, the amount of permitted revenue that can be produced from property tax. This becomes nearly prerequisite to the fashioning of any mathematical solution to the problem.

Variable "B" – Replacement Value of Improvements

Barring a major shift in the philosophy underlying the manner in which property is assessed, there are no apparent adjustments that can be made to the replacement value of property that would yield a sensible solution to the problem. If one were to focus on the value of improvements by either reducing these values or offering a form of exemption, there would be a clear differentiation being made between improved and unimproved property (whereby the owners of improved property would be gaining relief, while the owners of unimproved property would not).

The only other plausible option to using replacement value would be to use, in combination with land value, the market value of the property as a whole. This would be a radical departure from the traditional regime, and would undoubtedly result in a complete re-tooling of the entire valuation and ad valorem system. Because there is at least one proposal that would seem to espouse this approach, this will be explored at some length later in this paper.

With respect to both land and improvement valuations, it should be stressed that if it is desired to have a solution in place for the '05-'06 tax year, making material changes to the methods of valuation would not appear to be a practical solution. The reason for this is simple; the various assessors throughout the State would simply not have time to reassess properties within each county in time for the revised values to be in force for the '05-'06 tax year.

Bonding capacity for the State and various units of local government is based upon a percentage of total assessed valuation within their respective jurisdictions. Clearly, anything that would reduce total valuation would also reduce bonding capacity. This has to be recognized as an additional consequence of altering valuation structures.

Variable "C" – Depreciation

The variable that incorporates depreciation into the valuation equation must be taken into consideration when discussing the value of improvements. Nevada currently allows for the depreciation of the improvements to property in an amount of 1.5 percent of the replacement value per year, up to 50 years (or a residual value of 25 percent of the replacement value of the improvements).

Modifying this constant by accelerating the depreciation schedule or increasing the rate could offer additional tax relief. However, the relief would accrue only to those properties with improvements and, depending upon how it might be done, would likely afford older properties with greater relief than newer properties.

As many arguments can be raised with respect for doing away with the depreciation factor as can be made for modifying it. In and of itself, the depreciation factor – which is somewhat unique to Nevada – has contributed to a comparatively greater loss of valuation on older, lesser growing parts of the State. Given that the solution to the problem underlying this analysis must be applied on a State-wide basis, increasing the level or schedule of depreciation must be viewed as problematic.

Unless there is a decision to move from replacement value to another form of value for improvements, it is suggested that the depreciation application not be viewed as even a partial solution to the problem at hand.

Constant - Assessment Ratio at 35 Percent, and Constant - Value per $100 of Assessed Valuation

Without going into a lengthy history, 35 percent has been used for several years to modify the taxable value into the assessed value. Likewise, the division of the assessed valuation by $100 has traditionally been used to modify the assessed valuation for application against the combined tax rate. These values, like all other values used in the equation, are set in State statute.

As a note, multiplying the taxable value times .35 and dividing that product by $100 is the same as multiplying the taxable value by $.0035. Likewise, if the decimal place in the tax rate (e.g., $2.85) were moved two places to the left (e.g., $.0285), there would be no reason to divide the assessed valuation by $100. This is an illustration that these factors are simply mathematical idiosyncrasies in the Nevada equation. This being said, it is clear that an adjustment to either value would produce a change in the product of the tax bill equation.

It would make little sense to consider changing the use of the $100 factor (which would, in turn, change the basis of the tax rates), as it would simply create confusion with respect to the units used to assess the tax.

Modifying the 35 percent assessment ratio, however, may at least be a debatable matter. However, much like the $100 factor discussed above, changing the assessment ratio would represent a significant departure from traditional methods used to assess and tax property in Nevada. In addition, modifying this factor simply to synthesize an adjustment to the tax bill seems to be without logical basis. Is it the assessment ratio, in and of itself, that has caused the aberration in values? The answer is clearly no. The assessment ration only modifies the values that precede it in the equation. However, could an alteration of the 35 percent factor lead to a uniform reduction in values – and thus a reduction in tax liability? The answer is yes. If one were looking for an expedient manner to condition the tax bill product, one could simply lower the assessment ratio. A lower assessment ratio applied to taxable value would yield a lower assessed value and, if all other things were held constant, a lower tax bill.

It must be cautioned here that there are at least two things that further complicate this option. The first would be the effect that a lower assessment ratio would have upon those counties that are already experiencing a loss of assessed valuation under the existing (35 percent) regime. The second would be, as noted earlier in this paper, the need to know the desired level of revenue or valuation growth to be allowed in the first and each succeeding year. Without this revenue growth objective, it would not be possible to modify the assessment ratio to produce the desired outcome. Since the permissible revenue growth levels would need to be used to fashion a modification to the assessment ratio, it begs the question as to whether the tax bill should be constrained by this factor or by one more directly relevant to the permissible revenue growth. In addition, this could prove to be a comparatively "high maintenance" manner of constraining the tax bill as there would need to be annual adjustments to the assessment ratio to produce the permitted annual revenue. This could prove to be both administratively and politically problematic.

Variable "D" – Combined Property Tax Rate

Several people have correctly observed that one way to maintain mathematical equilibrium in the tax bill formula in light of rising valuations would be to adjust tax rates. As valuations increase, tax rates can be lowered to produce similar amounts of revenue. However, this is a somewhat simplistic way of looking at the tax rates.

Several components of the combined tax rate are set by law as specific levies per $100 of assessed valuation. Examples of this would include the $.50 and $.25 levies per $100 of assessed valuation that are levied on behalf of K-12 education. Other examples would include levies that are fixed in amount per law for Cooperative Extension, indigent programs, support of Family Court, and capital programs. Beyond the levies set in statute, there are also levies that have been approved by the electorate, in specific amounts, to fund certain programs. Examples of these would include levies in support of school building programs, police protection, road programs and the like.

Tax levies are also made in support of debt service on bonded indebtedness. While the levies are usually bounded by coverage, reserve fund and other requirements imposed by the bond covenants, extreme care must be taken in considering modifications to tax rates to not impair the repayment of debt. Likewise, Nevada is already considered a limited tax state by the credit markets. Further limitations on taxes pledged for repayment of debt will likely not be viewed as a "plus" for Nevada's credit. To what extent it might be viewed as a "minus" would need to be considered.

It is correct to say that the levies set in statute can be adjusted by the Legislature. However, extreme care would have to be taken to insure that the levies are adjusted on a proportional basis. If the levies are not proportionately adjusted, the outcome would be that certain units of government, or certain programs, could be disproportionately impacted by the adjustment. By way of example, if the levies set in statute are not proportionately adjusted, the entire impact of the revenue reductions necessary to achieve tax relief would be born by cities, counties and certain special purpose districts. In this example, those units of government with fixed rates would receive a windfall in tax revenue, while those without fixed rates would be dealt a devastating revenue blow. This would be extremely problematic in both regards.

Another thing to bear in mind with respect to tax rates would be the need, once again, to know the level of permissible revenue that each unit of government would be allowed from year to year in order to set the various tax rates. Thus, a determination would need to be made in advance as to the level of revenue to be allowed for each governmental unit for the initial and each subsequent year. This brings to mind a feature of tax rates that may make this option less desirable; that is, the fact that tax rates would need to be re-set annually to maintain levels of permissible revenue growth. In the initial year, the adjustments to the various tax rates would certainly be downward. However, in subsequent years, depending upon future growth in valuation, the rates may need to be adjusted either upward or downward to maintain desired revenue levels. In years where this adjustment would be downward, it would certainly be more popular than years that required an upward adjustment.

It should also be added that an acceptable method of differentiating tax rate adjustments between the various counties would need to be developed. In other words, a downward tax rate adjustment in a county experiencing rapid growth in assessed valuation would produce far different results than a similar adjustment in a county with declining assessed valuation. This is a similar problem to that which would be encountered in attempting to adjust the assessment ratio.

The foregoing raises another point of consideration. A reduction in tax rate would clearly benefit those who had a lesser increase in assessed valuation than those who had a comparatively larger increase. Those experiencing decreases in assessed valuation, all other things held constant, would receive an even more disproportionate benefit.

It is the discussion of tax rate adjustments that raises an important point regarding the interplay that exists between State and local budgets, particularly in the area of education funding. Simply put, to the extent that locally generated revenues from property taxes are higher, the State's funding requirement for education is reduced. Conversely, to the extent that locally generated revenues are lower, the State's funding obligation increases. Because of this, it should be cautioned that constraining the future levels of revenue growth from property taxes at a level less than the historical norm would have a direct impact upon the State's funding obligation for public education.

One additional factor that would need to be addressed in considering a tax rate solution to the problem would be the relationship of existing – and adjusted – tax rates to the current Constitutional and statutory caps on combined property tax rates.

Product “E” – Tax Bill

Some methods of suggested remediation do not attempt to modify a variable to the left side of the “=” sign. Instead, some would seek to modify the product – the tax bill itself. Examples of this type of modification would include “freezing” the amount of the tax bill (to the prior year’s level of liability), the use of a standard deduction, tax credit, refund or the use of circuit breakers. Under these approaches, the computation of the tax liability (the left side of the “=” sign) can remain unaffected. It is the product of the tax bill computation that becomes constrained.

As with each of the variables and constants discussed above, one would need to have an idea as to the objective level of revenue that the regime would be expected to produce in order to set limitations on the tax bill product.

Departures from Traditional Methods of Assessing and Taxing Property

Non-traditional methods of providing tax relief – that is, those that use a structure that is dramatically different than the one now used by Nevada to compute tax liability – would include several of the methods described in the immediately preceding section (i.e., credits, refunds, deductions, etc.) as well as those that would espouse a change in the assessment regime. At the forefront of these proposals would be the one that suggests a shift to a California-style regime that rolls back valuation, shifts valuation to a market base, and caps property tax liability as a percentage of value.

The necessity of shifting to a new assessment regime when mitigation of the spikes in tax liability can be effectively managed within the existing regime through a number of approaches seems questionable. This is particularly true when one considers the consequences of such a shift that have resulted elsewhere. While these methods may have achieved short-term tax relief, they have led to a number of consequences including a lack of equity, negative credit implications, loss of economic neutrality and revenue instability. Neither the nature of Nevada’s current challenge nor our desire to adhere to sound taxation principles would warrant a shift to such an approach.

Proposed Methods to Provide Tax Relief

Among the methods of remediation that have been suggested thus far are the following:

1. Limiting the growth in taxable value of a parcel of land and improvements that appeared on the previous year’s tax roll to no more than six percent in the subsequent year. If the growth in value of the property is less than six percent, the lesser value would apply. This limitation, or cap, would not include the value of new property that appears on the roll for the first time.

2. Limiting the growth in taxable value of a parcel of land and improvements that appeared on the previous year's tax roll to a fixed percentage (e.g., three percent), or the percentage increase in the Consumer Price Index, whichever may be less. New property, presumably, would not be included within this cap.

3. Limitations upon the growth in taxable value of a property that appeared on the previous year's tax roll to a fixed percentage that falls within the ranges established by methods 1 and 2, above.

4. Placing a "freeze" upon the '05-'06 tax liability of property that appeared on the tax roll in the prior year at the level of taxes paid in the prior year. During the one-year period of frozen tax liability, a determination would have to be made – presumably through an interim study – as to how that property would be treated in subsequent tax years.

5. Excluding a portion of the taxable valuation of a property (e.g., the first $100,000 or some other amount of value) from taxation, thereby granting relief in the form of an exemption. The amount of the exemption could be perpetual, and may be indexed by an inflation factor.

6. Treating a portion of the taxable value of a property (e.g., the first $500,000 in value) differently than amounts above the stated threshold. The value set for the threshold may be perpetual and/or may be inflation adjusted.

7. Using a "smoothing technique" to mitigate the spike in value. This approach would likely use a form of "moving average" to smooth out the aberration over time.

8. The use of targeted tax relief mechanisms, otherwise known as "circuit breakers" to provide relief to those most in need of relief. This would be a "means-tested" approach, whereby those that qualify, due to lack of means, would receive the relief.

9. The use of a declaration of severe economic hardship resulting from the increases in values and their associated tax implications. This, which would clearly seem to offer the Legislature more Constitutional latitude, could be used in conjunction with several of the above methods.

10. Conversion of Nevada's system of assessment and taxation to something that more closely emulates the regime used in California. This is a market value-based approach that re-bases the value of property at the time of sale and limits the amount of property taxes that can be levied to a fixed percentage of the market value.

11. Reduce tax rates. This would require an analysis of which rates can and cannot be adjusted, which will be no trivial pursuit. It also has the potential to place an increased burden on operating rates, which have the greatest amount of flexibility.

12. Reimbursement or future tax credit. Return any collections that exceed budgeted requirements back to the taxpayer in the form of a rebate or allow overages to accrue as an offset to future tax liability. The legality of such action remains in question. Should a rebate be allowed, a more progressive alternative might be to use excess funds to mitigate the cost of housing for lower income families.

13. The use of a standard deduction from the tax bill. A deduction is distinguished from an exemption in that it occurs after the assessment process has taken place and taxable value is assigned to each property. Again, there are legal issues that are outstanding here, but if at the "tax bill level" one could provide a $100, $200 or $500 standard deduction this might be viewed as more analogous to an adjustment in the tax rate as opposed an alteration in how the property itself is assessed (as is the case with the standard exemption).

14. The creation of a property tax credit that can be used when paying governmental services tax. Eligible homeowners and tenants who pay property taxes, either directly or through rent, on their principal residence in Nevada would be eligible for either a deduction or a refundable credit on their annual Nevada Governmental Services Tax. For example, qualified residents could deduct as much as 100% of their property taxes due and paid or $1,000, whichever is less. For tenants, 15 percent of rent paid during the year is considered property taxes paid. The minimum benefit is a refundable credit of $50. This proposal assumes that the property taxes (that would be used, in part, as a credit) would be paid at the higher (non-reduced) assessed value levels. If this were not the case, the tax credit would create a significant revenue loss for local governments and school districts that rely upon the Government Services Tax.

Matrix

A rational way to compare and contrast the various proposed methods is to measure their respective compliance with the goals and principles of taxation noted earlier in this paper. Using these measurements, one can get a better idea as to which of the above provide for a better potential outcome. This comparison, presented in matrix form, appears as Attachment A to this paper. For ease of comparison, colors have been used to distinguish degrees of compliance with the various goals and principles. Green generally indicates that the method satisfies the particular goal or principle. Yellow indicates that the method either somewhat satisfies the goal or principle, or that the degree to which the goal or principle is satisfied is uncertain (due to a lack of definitive detail with regard to the proposal). Red indicates that the method fails to satisfy the principle.

Clearly, a matrix such as this is useful only as a tool for discussion. For any of the methods listed herein, the "devil is in the details". That is, absolute compliance with the goals and principles can only be finally measured once all details are determined. By way of example, determination of Constitutionality can only be determined by legal experts and oftentimes, final determination of legality can only be ascertained when all details are presented. However, other measurements of compliance with goals and principles can be more readily made based upon a conceptual basis. For example, despite a lack of detail, it is safe to say that a system that would provide for reassessment based upon sale of property (such as with a California-style assessment system) would undoubtedly result in a loss of economic neutrality, and horizontal and vertical inequities.

Discussion and Recommendations

In giving consideration to any method of providing tax relief, there are certain prerequisite issues that must be addressed and determined. The first is an identification and understanding of the problem that is being addressed. Are we addressing a fundamental flaw within our overall system of assessment and taxation, or are we addressing an aberration in the throughput of our system. If we are addressing a fundamental flaw, then consideration has to be given to overhauling the system's structure such that the flaw is eliminated. If we are dealing with a short-term aberration, then we need to deal with the short-term effects created by the aberration.

There is little, if any, evidence to suggest that we are dealing with fundamental flaws to our system of assessment and taxation. There is, however, a coalescing of viewpoints around the current problem being an aberration. Thus, we would appear to be better served to focus upon dealing with the aberration at hand than attempting to overhaul the entire system of assessment and taxation in response to a short-run issue. Agreement with this premise would tend, then, to eliminate those proposed methods of mitigation that would seek to overhaul the entire Nevada system.

Second, prerequisite to the fashioning of any solution that would regulate the amount of revenue that will be generated from year to year (by constraining the amount of tax liability that individual taxpayers would pay) is the need to identify the level of constraint desired. As stated near the beginning of this paper, there is no question that mitigation of the spikes in tax liability is necessary and, frankly, inevitable. The question that remains is the extent of mitigation. It must be reiterated here that we are dealing with a two-pronged issue: 1) that which pertains directly to the taxpayer, and 2) that which directly affects the units of government that provide services to the taxpayer. Neither should be neglected in choosing a method of mitigation. Too little relief to the taxpayer and too much governmental impact both create undesirable consequences. Thus, it is essential that the level of relief be carefully deliberated. It is this decision that determines whether a credit of "X", and exemption of "Y", or a cap of "Z" should be implemented.

To further this discussion, consider the initial mitigation proposal proffered by the Clark County Assessor. This proposal suggested that a cap of six percent be placed upon the growth in value of property that appeared on the prior year tax roll, with new property coming on to the roll at its true value. If the growth in value of the property is less than six percent, the growth in value would be the lesser value.

To be clear, this proposal was intended to act as a restraint mechanism. That is, it was intended to restrict the amount that property values would be allowed to increase from year to year. However, and perhaps unfortunately, the proposal came to be viewed more as an allowance for government to grow by six percent per year than as a restraint upon that level of growth. For these reasons, alternative proposals that would reduce the six percent growth restriction to lesser amounts were offered (ranging from zero to six percent, and including Consumer Price Index alternatives).

Simply put, the original proposal of six percent was intended to mirror the historical growth of property value – in aggregate – that existed on the prior year tax roll. Thus, it can be stated that amounts of growth in excess of six percent would generally be above historic norms, while amounts below six percent would be below historic norms. The idea underlying this original proposal was to guarantee government no more or no less than it had received historically. Consequently, those proposals that suggested amounts less than six percent as a growth cap were suggesting that government be allowed less than the historical norms.

There is little question that the original capping mechanism proposed would have accomplished the task of mitigating the spikes in valuation and, thus, the spikes in the tax bills. There is also little question that this suggested approach focused the method of mitigation upon the variable that was responsible for the spike – the taxable valuation (driven by increases in land values). This proposal would also score well in the areas of predictability, uniformity, ease of administration and stability. The same can be said of those proposals that suggested cap amounts of less than six percent, although the production of revenue less than historical norms would be a by-product of the lower percentage proposals.

An attractive alternative to the capping mechanism would be the use of an exemption of a portion of the overall taxable or assessed valuation of a property (e.g., first $500,000 of taxable value of a parcel, or first $100,000 of assessed valuation of a parcel). Whether this occurs through an excluded (from taxation) portion of the taxable or assessed valuation, or alternative treatment of a portion of the taxable or assessed valuation, there are appealing elements of this approach. First and foremost, this would likely be viewed as something of direct value to the property owner, as opposed to an "allowance' for government. Second, it also addresses directly the primary source of the problem – increases in value. It is also predictable, stable, uniform, and progressive, among other things. The legality of such an approach is untested. However, legal compliance would likely be a function of details. If a more direct original capping mechanism can not be used, this approach would seem to have the broadest appeal.

The use of a smoothing technique, which serves to "smooth out" anomalies in trend lines, could be used to reduce the spiking effect of property valuations. This technique is otherwise referred to as a "moving average", and is used elsewhere in Nevada tax law to reduce variations in trends. By way of example, a three-year moving average would take the property valuation from the current tax year ('05-'06), and add it to the valuations for the two preceding years ('04-'05 and '03-'04). This sum would be divided by three, and the resulting average would represent the value for the current year. In the succeeding year, the '03-'04 value would be dropped, and the '06-'07 value would be added. The appeal of this approach is that it has the effect of smoothing short-run volatility. The predictable downside to this approach is that it does not eliminate the increase in values; it only spreads them out over time. However, if the moving average is conditioned or discounted, this problem can be minimized.

The next classification of tax relief methods involves the declaration of an economic hardship resulting from the large increases in value. Such a Legislative declaration provides more Constitutional latitude for the Legislature in forging a solution to the problem. This type of declaration could be used in conjunction with a number of the relief methods discussed herein, but may be more particularly associated with the use of "circuit breakers" or other forms of exemptions or exclusions. These are more generally associated with the provision of tax relief where ability to pay is called into question.

The use of relief methods that would provide for tax credits, reimbursements, or the offsetting reduction of other taxes would fall into the category of methods that condition the right side of the "=" sign, where exemptions, exclusions and caps condition the left side of the "=" sign. In comparison to the other methods discussed herein, these approaches may be considered somewhat esoteric in that they attempt to bring a solution about through the introduction of new - and perhaps less directly associated – variables into the mix. However, elements of this set of approaches may have appeal as a part of an overall, blended solution.

The use of alterations to tax rates as a means of providing tax relief, while possible, can also present more problems than might be expected. This was discussed at some length in a preceding section. Bottom line, because of the number of issues that this approach would envelop into a potential solution, it is recommended that this not be the course of action taken. Of course, if no other workable solution can be determined, this can be revisited.

As noted near the outset of this section, we are not dealing with a fundamental flaw within our system of assessment and taxation. For this reason, consideration of methods that would radically overhaul Nevada's system – such as implementation of a California-style tax limitation system – would appear to be well beyond the scope of solving the problem at hand. Further, the extreme lack of equity, predictability and economic neutrality inherent within such systems should exclude them from further consideration.

The placing of a "freeze" on the tax liability of property owners should also be discussed. Under this proposal, as it is understood, the tax liability of a property owner would be frozen at the level of the prior year. New property would likely come on to the tax roll at its new value, which would allow for some level of revenue growth. During the year of the freeze, the matter would be further studied to determine what method of restraint or control should be subsequently put into place. In essence, the discussion taking place in this paper and elsewhere would further take place during an interim period. Decisions regarding years beyond the year of the freeze would be identical to those presented herein; however, the timing of those decisions would be delayed until a later time. If a solution other than the freeze can be confidently arrived at during the first two months of the Legislative session, the use of a freeze can possibly be avoided. However, if a satisfactory solution can not be crafted in the early part of the session, the likelihood of passage of a freeze (or something similar in intent) may increase. The most concerning issue relative to the freeze proposal, other than the obvious impact upon governmental revenue, would be the uncertainty associated with succeeding years. This can create impediments to planning during the interim, as future conditions would be less certain than with a solution that addresses future years. The issue of who receives the greatest degree of benefit under such a proposal must also be considered. It would only make sense that those who would receive the greatest benefit or protection are property owners with property that increased in value the most. Those owning property that increased in value at lesser levels would, naturally, receive less benefit.

In the end, the best solution might draw components from more than one of the proposals discussed above. As noted earlier in this paper, there may well be a best near-term solution followed by a best long-term solution. Changing conditions within our economy would suggest that this would be the case. Changes to our Constitution that would permit more flexibility in addressing problems as they arise would be well worth considering. The goal should be both the best near-term and long-term solutions.

PROPERTY TAX COMPARISON MATRIX

Alternative (Method)	Description	Constitutionality	Ease of Administration	Ease of Compliance	Predictability	Transparency	Stability	Uniformity	Vertical Equity
1	Limiting the growth in taxable value of a parcel of land and improvements that appeared on the previous year's tax roll to no more than six percent in the subsequent year. If the growth in value of the property is less than six percent, the lesser value would apply. This limitation, or cap, would not include the value of new property that appears on the roll for the first time.								
2	Limiting the growth in taxable value of a parcel of land and improvements that appeared on the previous year's tax roll to a fixed percentage (e.g., three percent), or the percentage increase in the Consumer Price Index, whichever may be less. New property, presumably, would not be included within this cap.								
3	Limitations upon the growth in taxable value of a property that appeared on the previous year's tax roll to a fixed percentage that falls within the ranges established by methods 1 and 2, above.								
4	Placing a "freeze" upon the '05-'06 tax liability of property that appeared on the tax roll in the prior year at the level of taxes paid in the prior year. During the one-year period of frozen tax liability, a determination would have to be made – presumably through an interim study – as to how that property would be treated in subsequent tax years.								
5	Excluding a portion of the taxable valuation of a property (e.g., the first $100,000 or some other amount of value) from taxation, thereby granting relief in the form of an exemption. The amount of the exemption could be perpetual, and may be indexed by an inflation factor.								
6	Treating a portion of the taxable value of a property (e.g., the first $500,000 in value) differently than amounts above the stated threshold. The value set for the threshold may be perpetual and/or may be inflation adjusted.								
7	Using a "smoothing technique" to mitigate the spike in value. This approach would likely use a form of "moving average" to smooth out the aberration over time.								
8	The use of targeted tax relief mechanisms, otherwise known as "circuit breakers" to provide relief to those most in need of relief. This would be a "means-tested" approach, whereby those that qualify, due to lack of means, would receive the relief.								

PROPERTY TAX COMPARISON MATRIX

Alternative (Method)	Description	Horizontal Equity	Economic neutrality	Flexibility
1	Limiting the growth in taxable value of a parcel of land and improvements that appeared on the previous year's tax roll to no more than six percent in the subsequent year. If the growth in value of the property is less than six percent, the lesser value would apply. This limitation, or cap, would not include the value of new property that appears on the roll for the first time.			
2	Limiting the growth in taxable value of a parcel of land and improvements that appeared on the previous year's tax roll to a fixed percentage (e.g., three percent), or the percentage increase in the Consumer Price Index, whichever may be less. New property, presumably, would not be included within this cap.			
3	Limitations upon the growth in taxable value of a property that appeared on the previous year's tax roll to a fixed percentage that falls within the ranges established by methods 1 and 2, above.			
4	Placing a "freeze" upon the '05-'06 tax liability of property that appeared on the tax roll in the prior year at the level of taxes paid in the prior year. During the one-year period of frozen tax liability, a determination would have to be made – presumably through an interim study – as to how that property would be treated in subsequent tax years.			
5	Excluding a portion of the taxable valuation of a property (e.g., the first $100,000 or some other amount of value) from taxation, thereby granting relief in the form of an exemption. The amount of the exemption could be perpetual, and may be indexed by an inflation factor.			
6	Treating a portion of the taxable value of a property (e.g., the first $500,000 in value) differently than amounts above the stated threshold. The value set for the threshold may be perpetual and/or may be inflation adjusted.			
7	Using a "smoothing technique" to mitigate the spike in value. This approach would likely use a form of "moving average" to smooth out the aberration over time.			
8	The use of targeted tax relief mechanisms, otherwise known as "circuit breakers" to provide relief to those most in need of relief. This would be a "means-tested" approach, whereby those that qualify, due to lack of means, would receive the relief.			

PROPERTY TAX COMPARISON MATRIX

Alternative (Method)	Description	Constitutionality	Ease of Administration	Ease of Compliance	Predictability	Transparency	Stability	Uniformity	Vertical Equity
9	The use of a declaration of severe economic hardship resulting from the increases in values and their associated tax implications. This, which would clearly seem to offer the Legislature more Constitutional latitude, could be used in conjunction with several of the above methods.	Green	Red	Red	Yellow	Green	Yellow	Yellow	Green
10	Conversion of Nevada's system of assessment and taxation to something that more closely emulates the regime used in California. This is a market value-based approach that re-bases the value of property at the time of sale and limits the amount of property taxes that can be levied to a fixed percentage of the market value.	Yellow	Green	Green	Yellow	Yellow	Yellow	Yellow	Yellow
11	Reduce tax rates. This would require an analysis of which rates can and cannot be adjusted, which will be no trivial pursuit. It also has the potential to place an increased burden on operating rates, which have the greatest amount of flexibility.	Green	Red	Green	Green	Green	Green	Green	Green
12	Reimbursement or future tax credit. Return any collections that exceed budgeted requirements back to the taxpayer in the form of a rebate or allow overages to accrue as an offset to future tax liability. The legality of such action remains in question. Should a rebate be allowed, a more progressive alternative might be to use excess funds to mitigate the cost of housing for lower income families.	Yellow	Yellow	Yellow	Green	Yellow	Green	Yellow	Green
13	The use of a standard deduction from the tax bill. A deduction is distinguished from an exemption in that it occurs after the assessment process has taken place and taxable value is assigned to each property. Again, there are legal issues that are outstanding here, but if at the "tax bill level" on could provide a $100, $200 or $500 standard deduction this might be viewed as more analogous to an adjustment in the tax rate as opposed an alteration in how the property itself is assessed (as is the case with the standard exemption).	Yellow	Green	Green	Green	Green	Green	Yellow	Green
14	The creation of a property tax credit that can be used when paying governmental services tax. Eligible homeowners and tenants who pay property taxes, either directly or through rent, on their principal residence in Nevada would be eligible for either a deduction or a refundable credit on their annual Nevada Governmental Services Tax. Qualified residents could deduct as much as 100% of their property taxes due and paid or $1,000, whichever is less. For tenants, 15 percent of rent paid during the year is considered property taxes paid. The minimum benefit is a refundable credit of $50.	Green	Yellow	Yellow	Green	Yellow	Green	Green	Green

Legend:

Green generally indicates that the method satisfies the particular goal or principle.

Yellow indicates that the method either somewhat satisfies the goal or principle, or that the degree to which the goal or principle is satisfied is uncertain (due to a lack of definitive detail with regard to the proposal).

Red indicates that the method fails to satisfy the principle.

Note: For those printing in black and white the color scheme is as follows: Green is Dark Grey; Yellow is Light Grey; and Red is Black.

PROPERTY TAX COMPARISON MATRIX

Alternative (Method)	Description	Horizontal Equity	Economic neutrality	Flexibility
9	The use of a declaration of severe economic hardship resulting from the increases in values and their associated tax implications. This, which would clearly seem to offer the Legislature more Constitutional latitude, could be used in conjunction with several of the above methods.			
10	Conversion of Nevada's system of assessment and taxation to something that more closely emulates the regime used in California. This is a market value-based approach that re-bases the value of property at the time of sale and limits the amount of property taxes that can be levied to a fixed percentage of the market value.			
11	Reduce tax rates. This would require an analysis of which rates can and cannot be adjusted, which will be no trivial pursuit. It also has the potential to place an increased burden on operating rates, which have the greatest amount of flexibility.			
12	Reimbursement or future tax credit. Return any collections that exceed budgeted requirements back to the taxpayer in the form of a rebate or allow overages to accrue as an offset to future tax liability. The legality of such action remains in question. Should a rebate be allowed, a more progressive alternative might be to use excess funds to mitigate the cost of housing for lower income families.			
13	The use of a standard deduction from the tax bill. A deduction is distinguished from an exemption in that it occurs after the assessment process has taken place and taxable value is assigned to each property. Again, there are legal issues that are outstanding here, but if at the "tax bill level" on could provide a $100, $200 or $500 standard deduction this might be viewed as more analogous to an adjustment in the tax rate as opposed an alteration in how the property itself is assessed (as is the case with the standard exemption).			
14	The creation of a property tax credit that can be used when paying governmental services tax. Eligible homeowners and tenants who pay property taxes, either directly or through rent, on their principal residence in Nevada would be eligible for either a deduction or a refundable credit on their annual Nevada Governmental Services Tax. Qualified residents could deduct as much as 100% of their property taxes due and paid or $1,000, whichever is less. For tenants, 15 percent of rent paid during the year is considered property taxes paid. The minimum benefit is a refundable credit of $50.			

Legend:

Green generally indicates that the method satisfies the particular goal or principle.

Yellow indicates that the method either somewhat satisfies the goal or principle, or that the degree to which the goal or principle is satisfied is uncertain (due to a lack of definitive detail with regard to the proposal).

Red indicates that the method fails to satisfy the principle.

Note: For those printing in black and white the color scheme is as follows: Green is Dark Grey; Yellow is Light Grey; and Red is Black.