The State Role in Providing Property Tax Relief

Andrew Reschovsky
Robert M. La Follette School of Public Affairs
University of Wisconsin-Madison
reschovsky@lafollette.wisc.edu

Selected Property Tax Facts

- Per capita property tax collections , 2002
  - Nevada: $786 State rank: 32nd
  - US average: $971
  - California: $864 State rank: 30th
  - Arizona: $782 State rank: 33rd
- Property tax revenue as a share of local government revenue, 2002
  - Nevada: 19.9% US: 27.1%
- Share of K-12 education revenue from state
  - **In 2000** – Nevada: 29.1% US: 49.5%
  - **In 1992** – Nevada: 38.7% US: 46.4%

The State Role in Property Tax Relief

- All states pursue policies to limit property taxes
- A wide range of policies are pursued
  - Process oriented: Truth in Taxation
  - Providing state aid to local governments (including school districts)
  - Taking over local government functions, e.g. criminal justice, social services
  - Finding alternative local government revenue
  - Explicit property tax or spending limitations

A Typology of Property Tax Limitations

- General limits (usually apply to all property taxpayers)
  - Property tax **rate** limits (ceilings) – found in 42 states for at least some governmental units
  - Property tax **levy** limits
    - Found in about half of the states
    - e.g. MA limits growth of levy to 2½% except new construction and voter overrides
  - Total revenue and/or spending limits
    - These force local governments to cut tax rates
    - Most strict limit is Taxpayer Bill of Rights in Colorado (passed in 1992)

A Typology of Property Tax Limitations
(cont.)

- General limits (usually apply to all property taxpayers)
  - Annual limits to assessment increases
    - Found in 15 states
    - Allowable percentage increases range from 10% (Arizona, Maryland, Texas) to 2% (California)
    - In a number of states cap is **lower** of CPI or limit
    - In policy statement, International Association of Assessing Officials strongly discourages the use of assessment caps

Statement on Assessment Limits by the International Association of Assessing Officers

Limits that constrain changes in assessed or appraised value of property may appear to provide control, but actually distort the distribution of the property tax, destroying property tax equity and increasing public confusion and administrative complexity. Owners whose properties are increasing in value more rapidly than the permitted rate of increase (say, 5 percent) receive a windfall at the expense of those whose properties are decreasing in value or are increasing at lower rates. In effect, <u>valuation increase limits result in lower effective property tax rates for owners of desirable property and higher effective tax rates for owners of undersirable property.</u> Legislators and the public should be made aware of these inequities and be actively discouraged from pursuing such limitations. Any other control is preferable.

IAAO, *Standard on Property Tax Policy*, August 1997.

Impacts of Texas 10% Assessment Cap

- Texas 10% cap approved as a constitutional amendment in 1997
- New legislative proposals call for reducing the %age
- Study of Dallas County in 2003 found:
  - Rapid assessment increases resulted in a loss of residential taxable value of $1.6 billion
    - Puts pressure on local services, especially schools with rate cap
  - Benefits of assessment cap went primarily to the wealthiest locations
  - Neighborhoods where most minorities live received “little or no benefit from assessment limit”

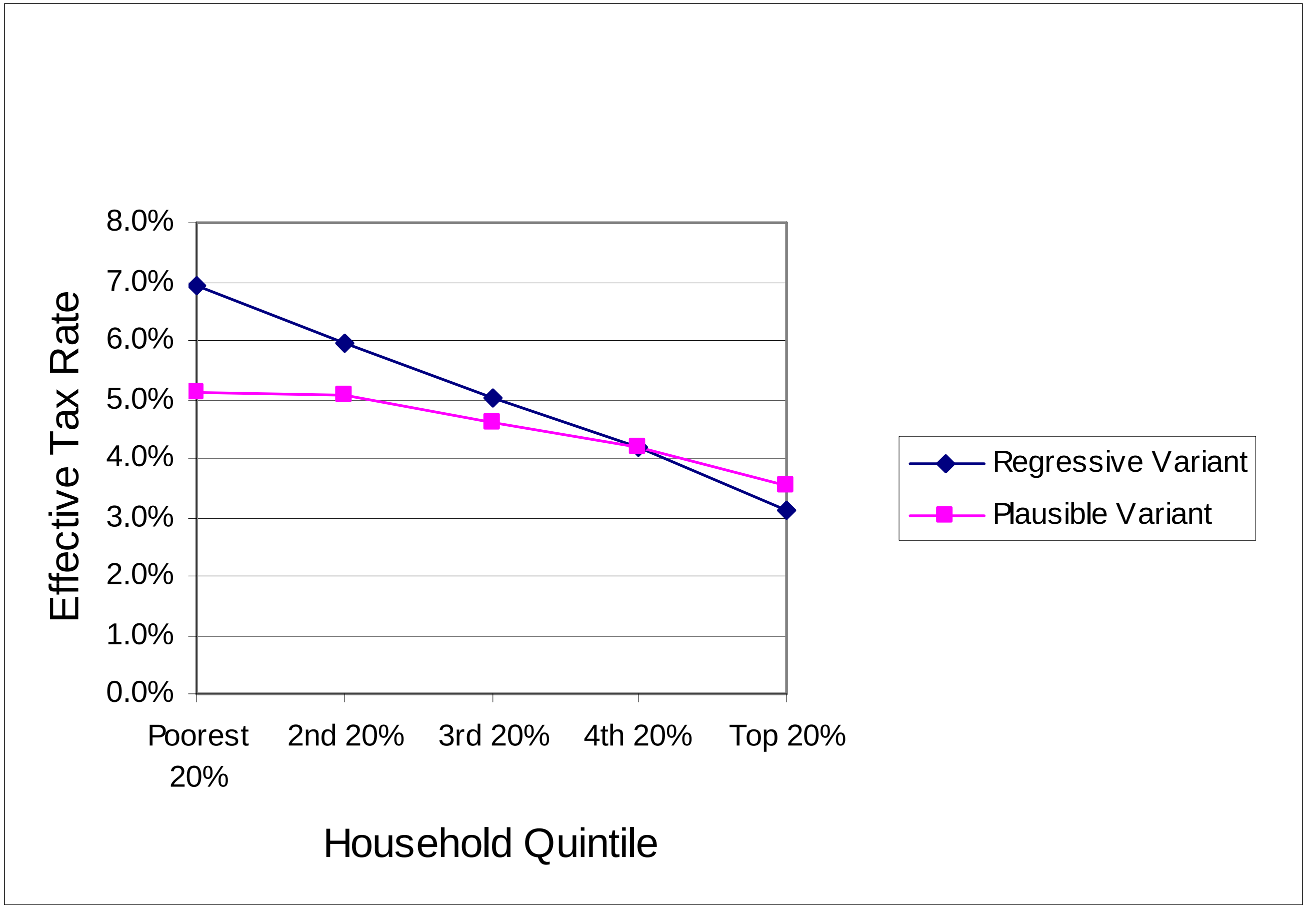
Impacts of Texas 10% Assessment Cap

- Business property values are much more volatile than residential property values
  - e.g. Travis County (Houston) business assessed value change: 1999 +9.7%; 2000 +15.1%; 2001 +11.3; 2002 –2.8%; 2003 –8.7%
  - Result: revenue loss can not be fully made up in boom periods, and burden shifts over time to residential property
- If cost of public services rise faster than assessment cap, result is cuts in services

A Typology of Property Tax Limitations (cont.)

- **Targeted tax relief**
  - To those with high **property tax burdens** (tax relative to income)
  - To a class of households, e.g. the elderly, to farmers, to the poor, to veterans, to the disabled
  - To a type of property, e.g. to homeowners
- Relief may be identical for all eligible households or may vary by income

Average Residential Property Tax Burdens by Income -- Wisconsin, 2001



Policies for Targeting Tax Relief to Specific Taxpayers

- **Circuit breakers** provide tax relief to taxpayers facing high burdens
  - In 1999, 27 states had circuit breakers
  - Many states limit eligibility to elderly
  - Some states limit eligibility to low-income households; renters are eligible in some states (in NV property tax equivalent to 8.5% of rent)

More on Circuit Breakers

- Relief is in form of rebate/refund or income tax credit
- Relief is generally a percentage of a household's property tax levy **in excess of** a threshold burden, e.g. 3% of income
- Participation rates are often less than 50%
  - Programs often poorly advertised
  - Separate application process is often extremely complex

Nevada’s Senior Citizen Property Tax Relief

- Eligibility limited to those over 62 with incomes under $24,448 (in 2004)
- Households can only have a limited amount of liquid assets
- Assessed value of house must be below $87,500
- Refund depends on property taxes and on income
- Applications must be filed with county assessors and program administered by the Division of Aging Services

Policies for Targeting Tax Relief to Specific Taxpayers

- **Homestead exceptions** generally exempt the first X thousand dollars of assessed value from property taxation
  - Can apply to all property owners, residential homeowners, or groups such as the elderly
  - Provides largest percentage relief to those with low-value properties
  - Some states reimburse local governments for revenue losses due to exemptions

More on Homestead Exemptions

- Programs vary substantially in generosity
  - Louisiana exempts first $75,000 of market value
  - Massachusetts exempts only the first $2,000
  - Eligibility is often limited by income and age

Policies for Targeting Tax Relief to Specific Taxpayers

- **Classified** property tax systems tax different types of property at different effective rates
  - Usually operates by assessing residential property at a lower rate than commercial-industrial property
  - Minnesota has complex classification scheme designed to increase progressivity of the property tax
  - Not possible in Nevada without a constitutional amendment changing the “uniformity” clause

Policies for Targeting Tax Relief to Specific Taxpayers

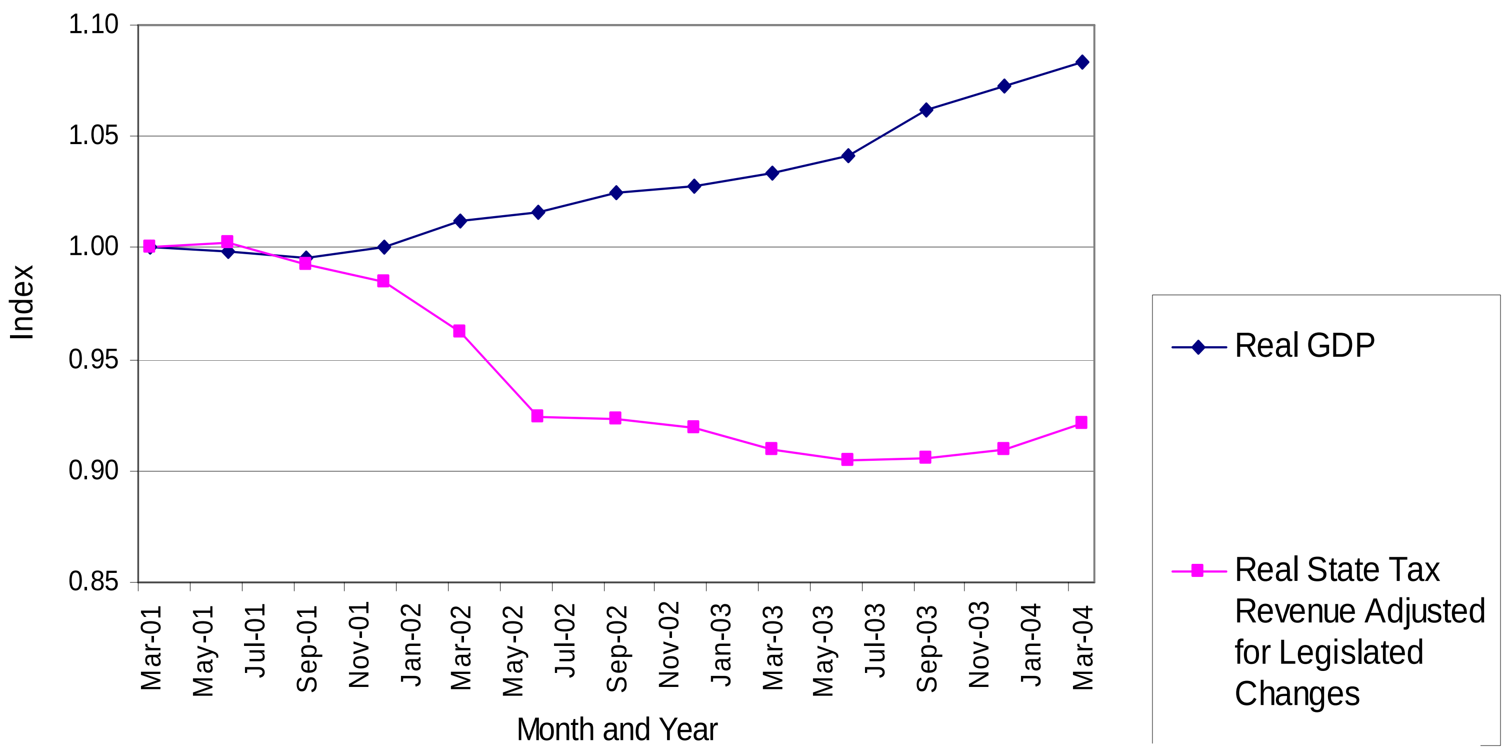
- **Property tax deferral** programs allow taxpayers to defer taxes until their house is sold (with the government in effect lending them money)
  - Fairer to non-elderly because real beneficiaries of tax relief to senior citizens are their heirs
  - Deferral programs found in 21 states
  - Participation in current programs is **very** low
  - Program could be available to **all** taxpayers who face high burdens or who face annual increase in tax bill above a threshold

Policy Issues Involved in Targeting Property Tax Relief

- Low participation rates, especially for circuit breaker programs
- Do property tax relief programs, by lowering the cost of government, actually lead to additional spending?
- Who funds tax relief—state or local governments?
  - If latter, will burdens be shifted from home-owners to renters or to business?

2001-2003—A Mild Recession, But Severe State Fiscal Crises

Real GDP and State Tax Revenue Since 2001



Source: Authors' calculations using revenue data from Jenny (2004) and GDP data from Bureau of Economic Analysis (2004).

State Governments Face Fiscal Pressure in Coming Years

- **Medicaid** spending continues to grow rapidly
  - The aging population, federal Medicare/Medicaid reform, and effort to reduce the federal deficit will place rising demands on state governments
- Increased enrollment and meeting the requirements of **No Child Left Behind** will place additional fiscal pressure on the state

Will We See a New Round of Property Tax Limitations?

- Legislatures in a number of other states are considering the adoption of new property tax (and in some cases spending) limits, e.g. Texas, Wisconsin, Maine
- Why now?
  - Response to economic uncertainty, rising job loss, declines in financial wealth
  - An aging population—baby boomers approaching retirement
  - Increasing numbers of taxpayers facing the AMT-and thus effectively losing their property tax deduction