

# Local Property Taxes in the United States: Common Challenges and Policy Responses

Nathan B. Anderson

Ropes & Gray LLP

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# Overview

- The “local property tax” means
  - Legal framework (the rules on paper)
  - Administration (the rules applied)
  - *Vocabulary* (labels)
- The local property tax is old, differs across states, and has changed over time within states
- The local property tax is unique
- **Goal today**: Highlight common legal framework, challenges and policy responses of a “traditional” market value property tax system in the United States.
- This “traditional” system forms the basis of state laws on property taxes and is often recommended by policy advisors, but is almost never actually applied in practice for any sustained period of time.
- This “traditional” system presents important challenges and evolving responses from state and local governments and voters

## Common Rules

- Legal Rules (set by the state)
  - Define the property tax base (what is taxable value)
  - Set parameters of local access to property tax base
- Accounting rules: Tax liabilities and government revenue
  - Government
    - Tax Revenue = (Tax Rate) x (Tax Base)
  - taxpayer
    - tax bill = (taxable value) x (Tax Rate)
      - Tax Rate =  $\frac{\text{Tax revenue (requested)}}{\text{Tax base}} = 1$
      - Multiply Tax Bill by  $\frac{\text{Tax base}}{\text{Tax base}} = 1$ , which changes nothing but perspective
    - tax bill = (share of Tax Base) x (Tax Revenue)

## Consider a market value system with unfettered access to property tax base

- Define Tax Base
  - Market value determines the taxable value of property
  - Taxable value is measured each year
  - For most properties, the measure is an estimate because market value is not observed if the property is not sold recently
- Parameters of access to Tax Base
  - Unfettered access to Tax Base
  - Step 1: Government requests an amount of revenue (“requested revenue”)
  - Step 2: measure taxable values and add them up to get Tax Base
  - Step 3: tax rate is set so that it yields requested revenue
  - Step 4: tax bill = (tax rate) x (taxable value)
- Property tax is a “residual tax”

# Unfettered Market Valuation System: Features and Challenges

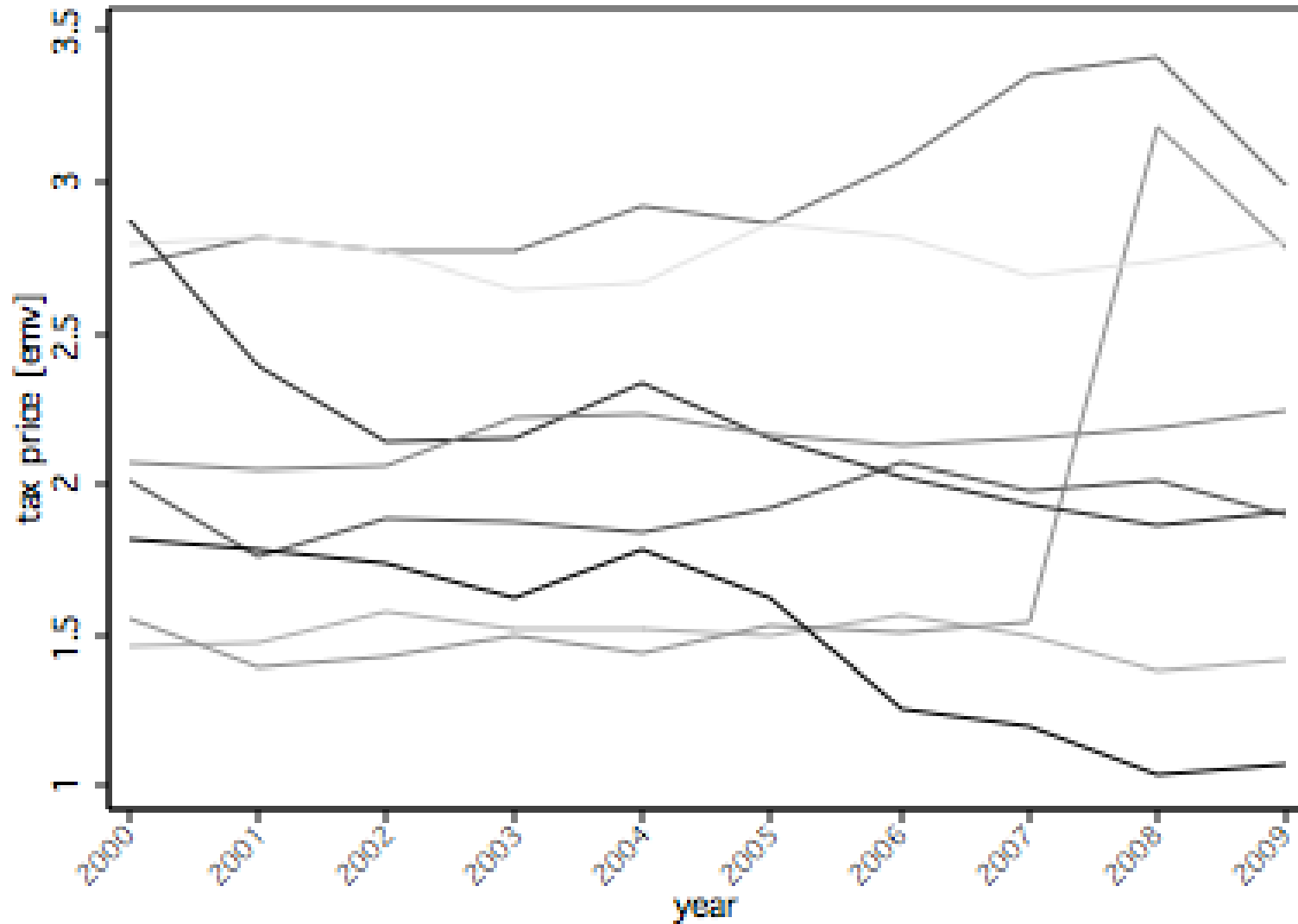
- **Administration:** applying and enforcing the rules across many jurisdictions is expensive and time consuming
- **Distribution of taxes** – in a particular year
  - $\text{tax bill} = (\text{share of tax base}) \times (\text{tax revenue})$
  - Share of total bill = share of tax base
  - In any year, owner of highest value property has highest tax bill
- **Complex and undesirable changes in tax payments**
  - tax bill changes caused by: (a) government changes its requested tax revenue or (b) share of tax base changes
  - Unpredictable and idiosyncratic property value changes cause unpredictable and idiosyncratic tax bill changes – liquidity problems and angst
    - Evidence: Majority of homeowners experience negative correlation between their own house value and their share of tax base
    - Tax bill changes not a clear signal of government revenue changes
    - Confusion over what causes tax bill to increase/decrease
- **Local decisions: local governments and voters**
  - Excessive local spending + debt: tax exporting and/or moral hazard
  - Leviathan power – excessive revenue relative to majority rule
  - Ability to monitor local government

The next two slides are background

## Simple Examples (background)

- At any time, tax bill equals the product of the taxpayer's share of the total Tax Base and the requested Tax Revenue.
  - $\text{tax bill} = (\text{share of Tax Base}) \times (\text{Tax Revenue})$
- Please note:
  - tax bill can change even if revenue remains constant, because an individual's share of Tax Base changes.
- Example: Year 1 -- School district has only two homes [Focus on home #1]
  - Each home has market value = \$200.
  - Each taxpayer has a 50% share of the Tax Base: Each pays \$0.50 for every \$1 of property tax revenue. ("tax share")
  - Local government requests \$1,000 of Tax Revenue.
  - Each pays 50% of \$1,000 = \$500 (Note that we got the tax bill without calculating the tax rate)
- Example: Year 2 (value up, but tax bill down)
  - Home #1 Value = \$225; Home Value #2 = \$250.
  - Home #1 tax share = 47%; Home #2 tax share = 53%
  - Local government requests same \$1,000 of tax revenue.
  - Home #1 tax bill = \$470 (down \$30 [6%]); Home #2 tax bill = \$530 (up \$30 [6%])
- Example: Year 3 (value down, but tax bill up)
  - Home #1 Value = \$200; Home Value #2 = \$190.
  - Home #1 tax share = 51%; Home #2 tax share = 49%
  - Local government requests same \$1,000 of tax revenue.
  - Home #1 tax bill = \$510 (up \$40 [9%]); Home #2 tax bill = \$490 (down \$40 [8%])
- These are stylized examples, but "tax share" variation can be important in understanding why tax bills change over time.

# Individual “tax shares” over time within one school district (background)



Note: A taxpayer’s “tax share” is the taxpayer’s share of total Taxable Value. The product of the tax share and Total Revenue (requested) equals the taxpayer’s tax bill. Here, “tax share” is shown per \$1,000 of revenue the local government requests.



## “Tax Limits” Vocabulary

- Tax Rate Limits
  - A maximum statutory tax rate that cannot be exceeded, except by override.
  - Explicitly constrain local government decisions
- Tax Revenue Limits
  - A maximum amount of requested revenue that cannot be exceeded, except by override.
  - Explicitly constrain local government decisions.
- Assessment Limits
  - A maximum amount by which the taxable value of a property may increase from one period to the next period.
  - Often “relaxed” upon a change in ownership
  - Does not, by itself, constrain local government decisions.
  - Not subject to override.
  - When combined with tax rate limits, may effectively constrain tax revenue.
- Common element: each one can directly constrain an individual taxpayer’s property tax payment and changes in such property tax payment.

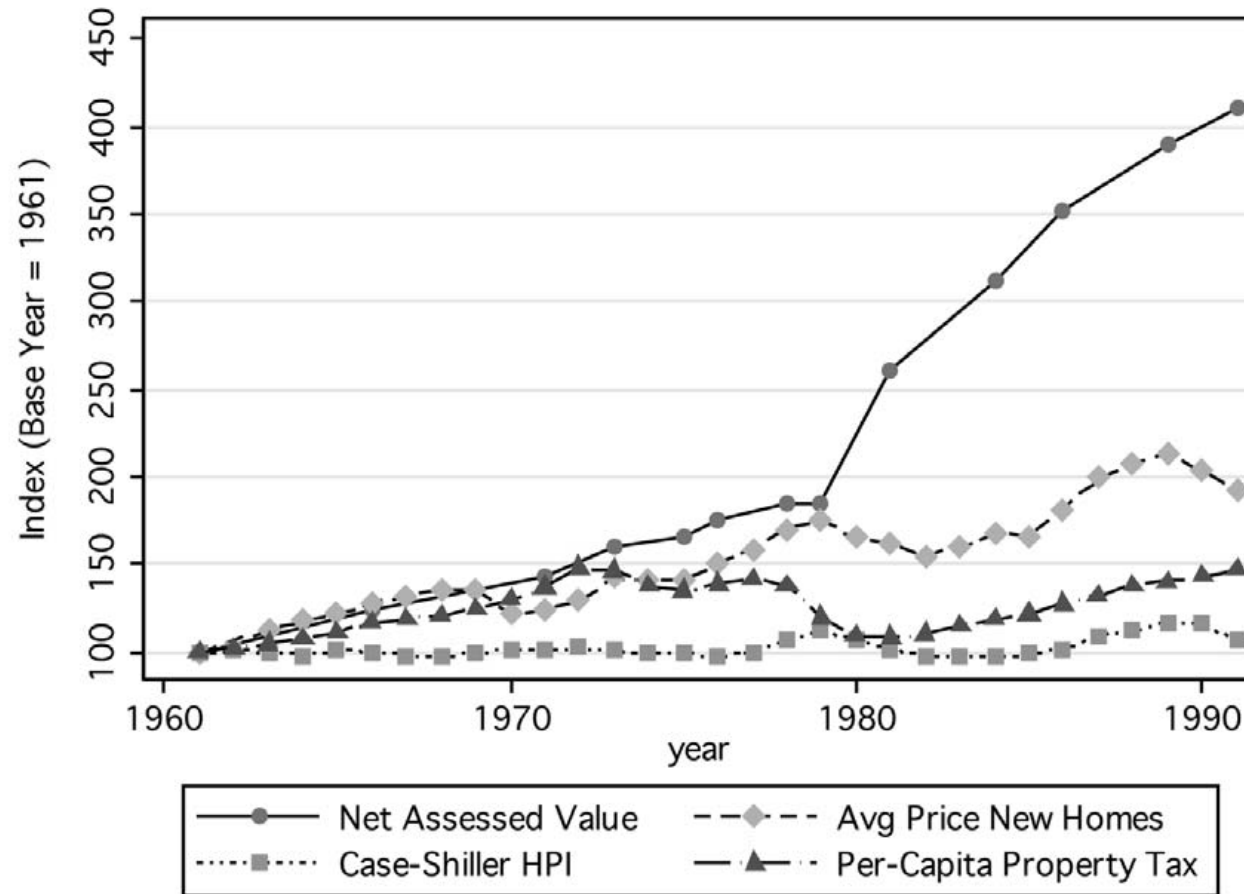
## Policy Responses: Within Property Tax System

- Tax Rate Ceiling
  - Unlikely to control Leviathan unless minimal changes in Tax Base
  - Tax bills only change when taxable value changes (value up, tax bill up)
  - Tax bills more predictable
- Revenue Ceiling
  - Can control Leviathan regardless of tax base changes
  - Tax bills more predictable
  - Tax bills may still exhibit negative correlation with property value
  - Easier to monitor government
- Assessment Ceiling
  - No control of Leviathan
  - Tax bills more predictable and more positively correlated with property value
  - Increases complexity
- Transparency – make easier to monitor government and understand property taxes
  - Notice of revenue increases and votes
  - Information and explanation on property tax statements
- Tax exemptions
  - shifting taxes across classes or owners of property (homeowners, commercial-industrial, elderly)
  - May increase excessive local spending

The next set slides focus on the move in the United States to an unfettered market value system and other changes in policy around that time.

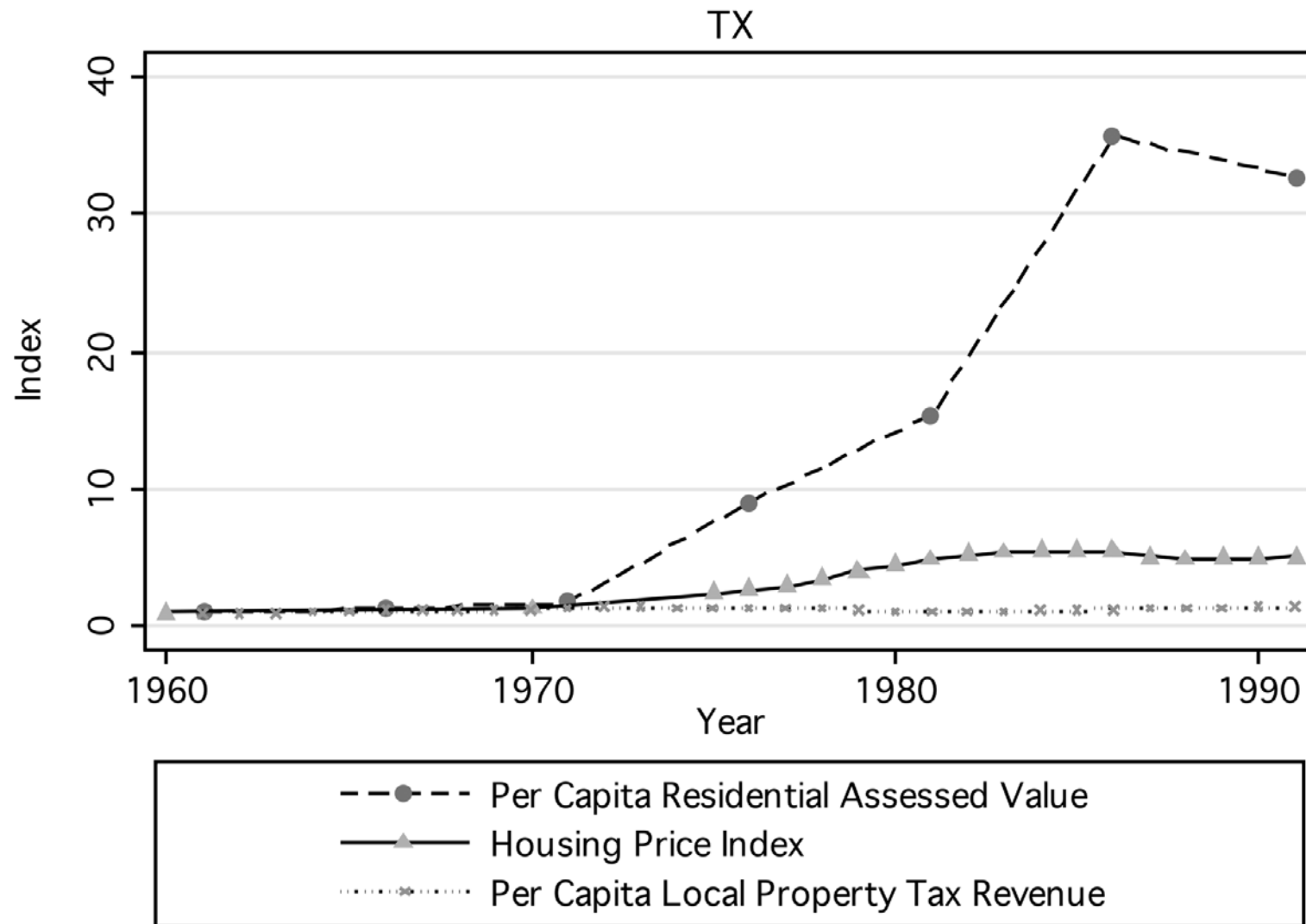
The changes observed in the assessment system are important, but it is not certain that they were a primary motivation for the widespread enactment of property tax limits that began around 1970.

## US: Massive Assessment Reforms in 1960s and 1970s



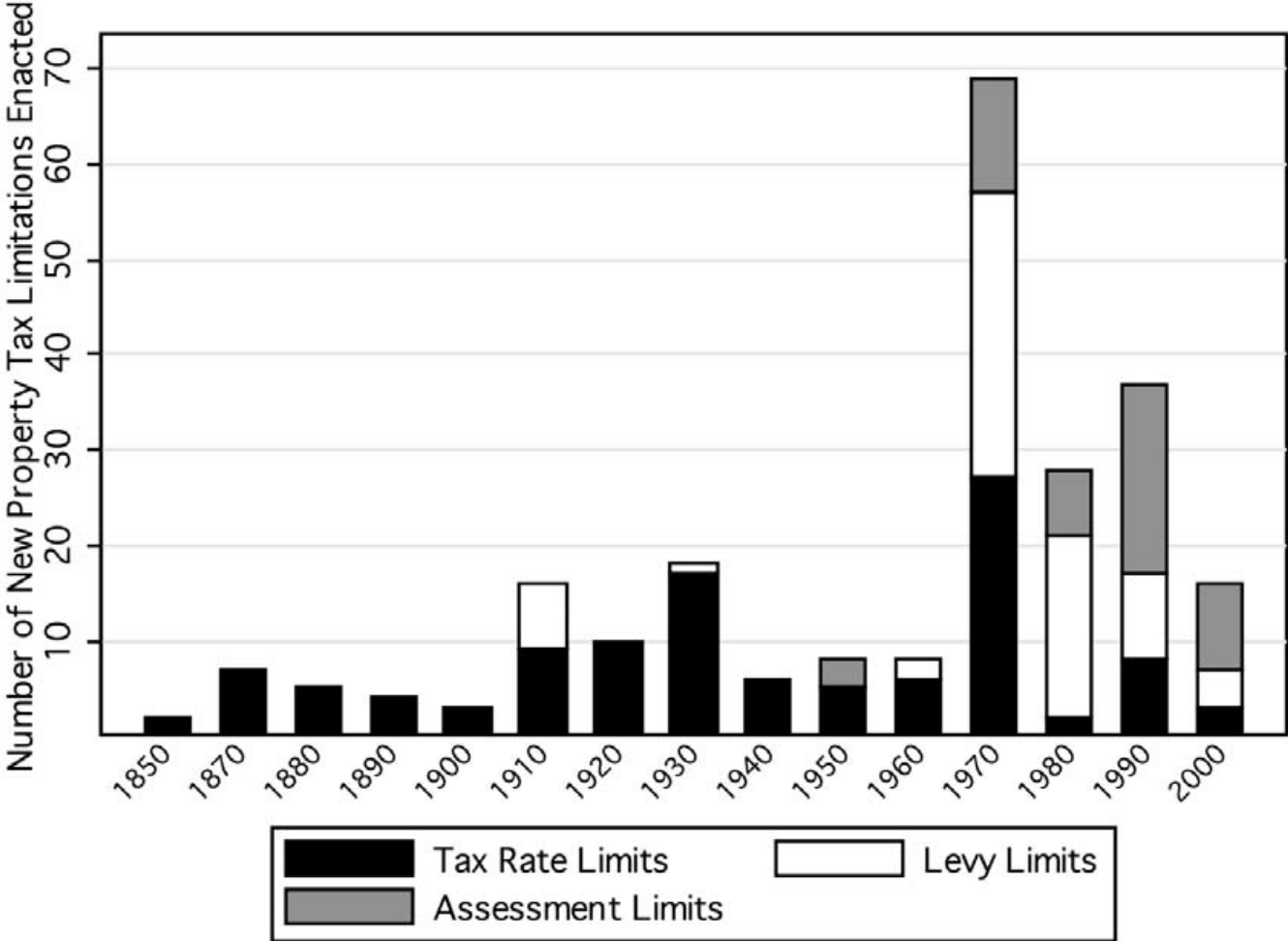
Note: Index is set to 1 in 1960. Source: Author's tabulations based on U.S. Census Bureau data on S&P Case-Shiller Housing Price Index

# Texas Assessed Values Compared to Housing Prices and Property Tax Revenue, 1960-1991



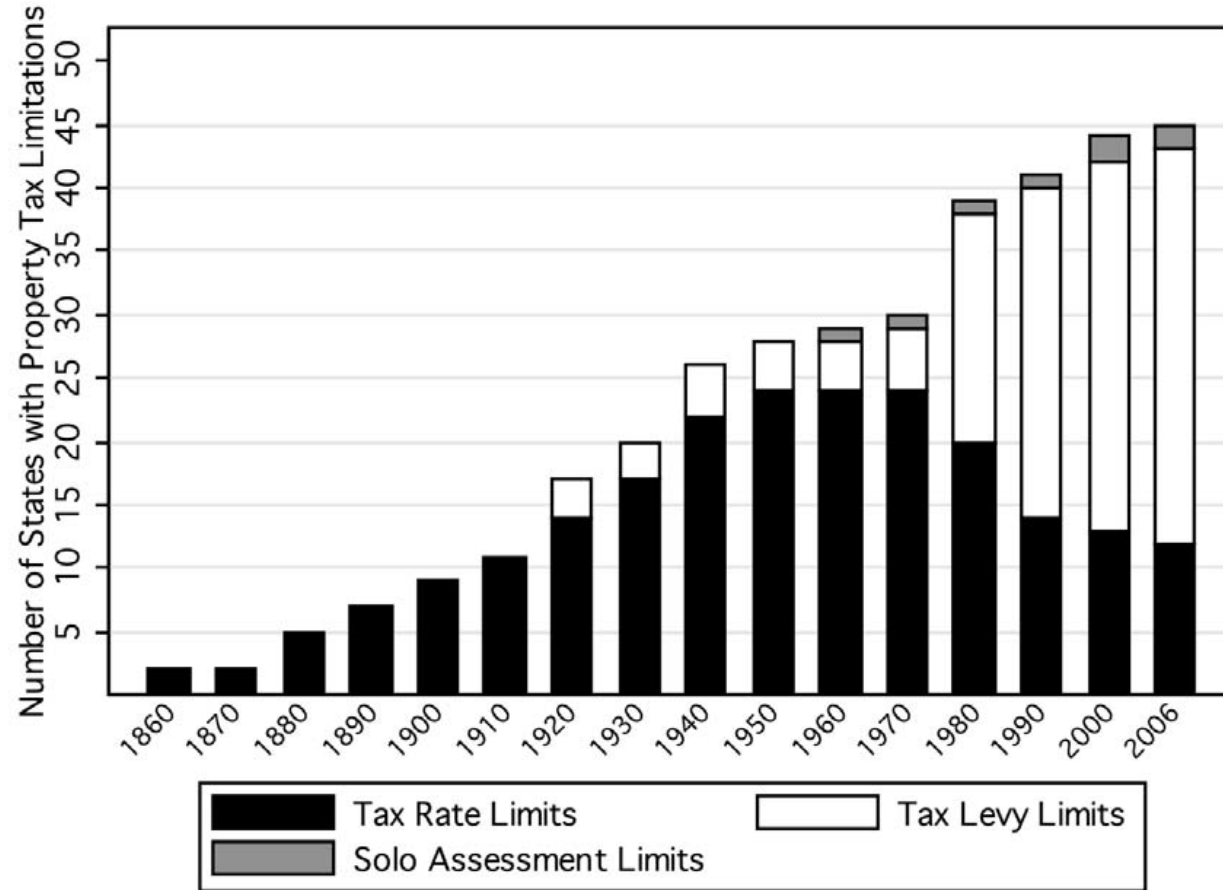
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# Tax Limits Enacted: 1850-2006



Note: Index is set to 1 in 1960. Source: Author's tabulations

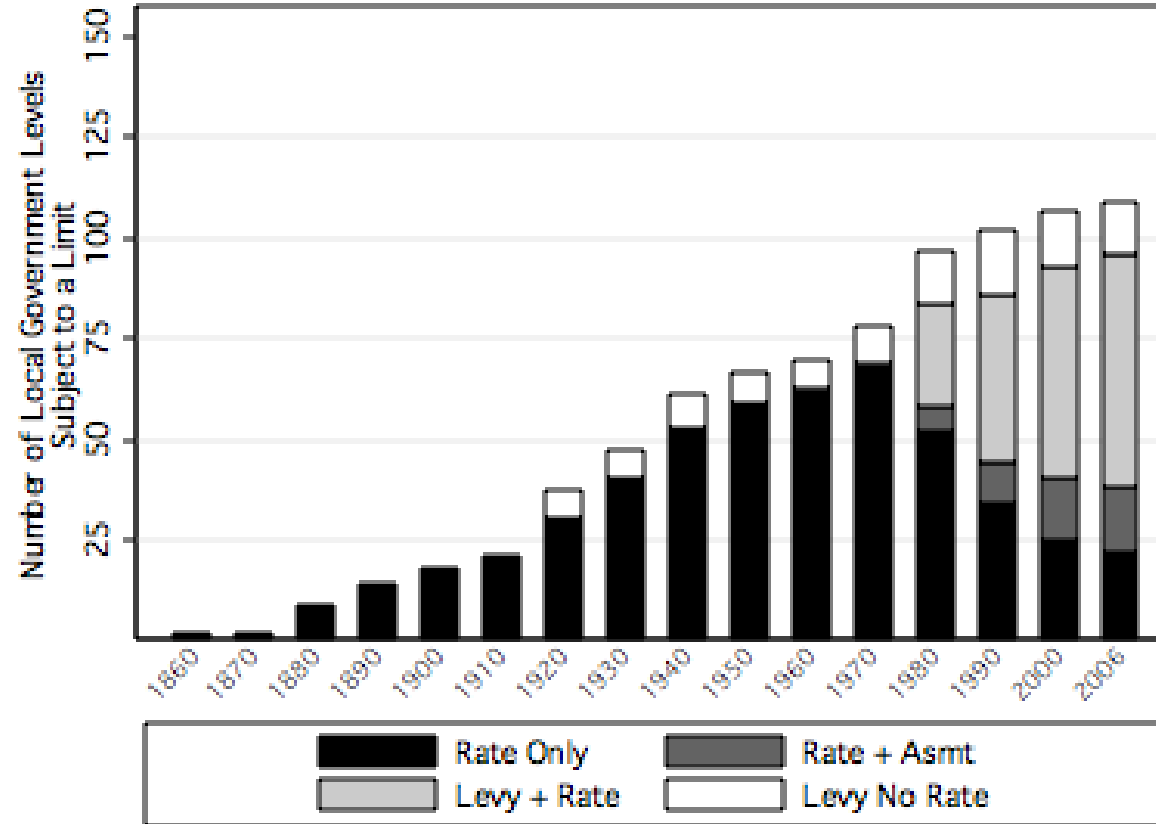
# Tax Limits by State: 1850-2006



Note: Index is set to 1 in 1960. Source: Author's tabulations

# Policy Responses?

Number of local government levels subject to statewide property tax limits that target revenue: by type of limit and combination



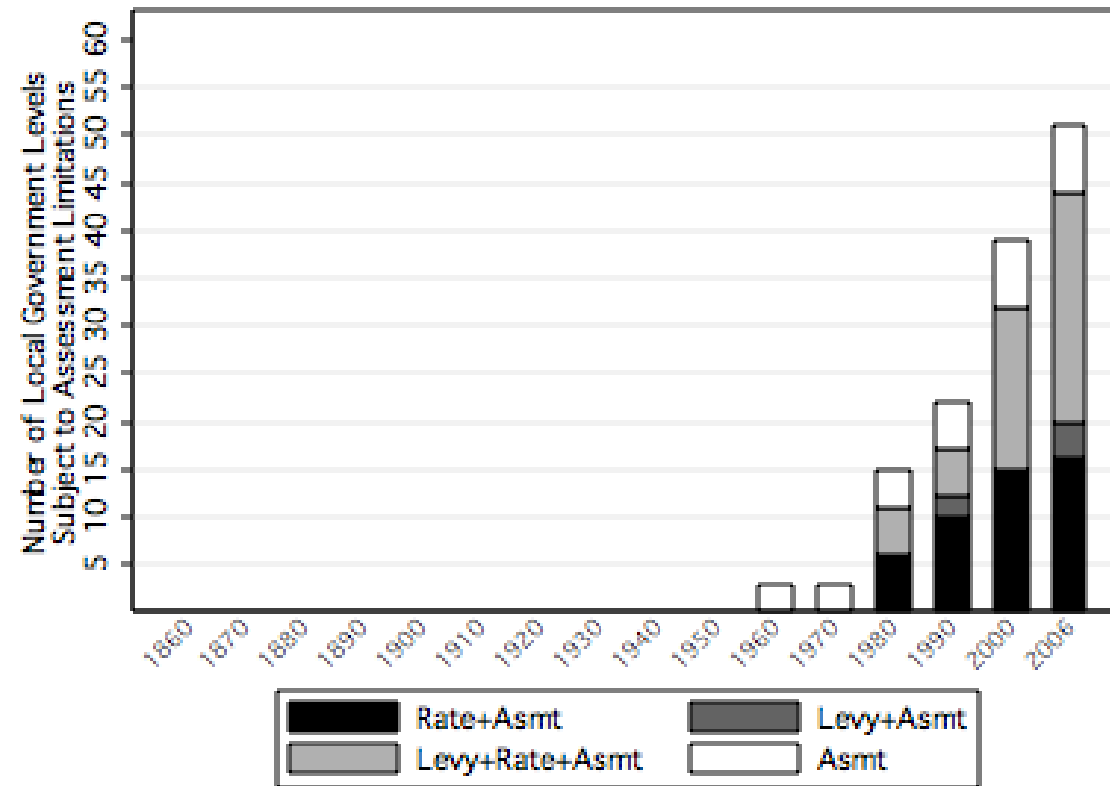
Types of limit: Tax Rate (Rate); Tax Revenue (Levy); Assessment (Asmt)

**Notes:** Rate sets a maximum tax rate; Levy sets a maximum revenue level or maximum annual percentage increase in revenue; Asmt sets a maximum percentage increase in taxable value from one valuation to the next. Local governments include counties, municipalities and school districts. E.g., if a state has a Rate limit on counties, a Levy and Rate limit on municipalities and no limits on school districts, the figure counts two levels of local government as limited.



# Policy Responses?

Number of local government levels subject to statewide assessment limits: by combination with other limits



Types of limit: Tax Rate (Rate); Tax Revenue (Levy); Assessment (Asmt)

**Notes:** Rate sets a maximum tax rate; Levy sets a maximum revenue level or maximum annual percentage increase in revenue; Asmt sets a maximum percentage increase in taxable value from one valuation to the next. Local governments include counties, municipalities and school districts. E.g., if a state has Rate and Asmt limits on counties, Levy, Rate and Asmt limits on municipalities and Levy and Asmt limits on school districts, the figure counts three levels of local government as limited.

## Takeaways

- Property tax is unique as a “residual tax” where government can choose revenue
- Think about cost-sharing within school districts
  - Tax Shares and Tax Revenues
- A pure market value based system may achieve uniformity at the expense of transparency and certainty, and may be unacceptable to many taxpayers
- Should we, and how can we, help taxpayers understand why their property tax bills change over time?
  - A property tax bill could include information on whether tax bill change was due to change in tax revenue or change in tax share.

Remaining slides are background

## Background: Assessment Limits

- Texas appears to be one of at least five states that enacted an assessment limit after revenue limits were already in effect.
  - Why have assessment limits if government is already constrained by a revenue limit?
    - Revenue limit not binding?
    - Relative appreciation in residential property shifting the tax burden to homeowners?
      - Why can't homeowners vote for lower taxes
  - Taxpayers want predictability – don't understand why large tax increases occur even when revenue limit is in effect?

# A Guide for Tax Policy

## A good tax

1. Is simple and transparent
2. Enhances rather than harms economic efficiency
3. Distributes its burden fairly across taxpayers of different abilities to pay
4. Distributes its burden fairly for a single taxpayer over time and with limited uncertainty

# Equity

## Potential Goal #1: To Replace Property Taxes With Other Taxes

Why would we want to do this?

- Because we fear that property taxes are regressive.
  - Even if true, replacement of the tax with other taxes is not a solution because:
    - Replacement is expensive
    - Replacement is not targeted towards relieving the property tax burden of low-income taxpayers
- Because there are disparities across school districts in property tax wealth.
  - Note that this is not a criticism of the property tax, per se
  - It is a criticism of relying on local resources to fund education
  - Solutions to resource disparities:
    - Centralize financing at the state level
    - Trade off: Loss in local control of district finances.
    - Redistribute resources to poor districts.

# Equity

## Potential Goal #2: To Reduce the Property Tax Burden on Poor Households

Why would we want to do this?

- Because we fear that the current property tax burden is not distributed fairly across taxpayers according to ability to pay
- Options for reducing tax burdens on poor households
  - “Circuit Breaker” program
    - Example: State government picks up the tab for any property taxes that exceed 5% of household income.
  - Income-qualifying credits
    - Example: State-financed reduction in taxable value for households with income less than \$30,000.
- Many “tax relief” programs do not reduce overall property taxes, but instead “shift” the property burden from one set of taxpayers to another set of taxpayers within the same jurisdiction and sometimes across the state.

## About the author

- Nathan Anderson is an attorney at Ropes & Gray, LLP.
  - Ph.D. in Economics from the University of Michigan (2005).
  - J.D. from Northwestern University Pritzker School of Law (2014).
  - Before joining Ropes & Gray, LLP, Nathan was an Assistant Professor of Economics, at the University of Illinois at Chicago and an Assistant Professor at the Institute of Government and Public Affairs, University of Illinois.
  - His research focused on the local property tax in the United States.