SPECIAL REPORT

State and Local Property Taxes

Total Collections To Exceed $250 Billion in 2001

Michael Fitzpatrick Lorelli
Adjunct Scholar
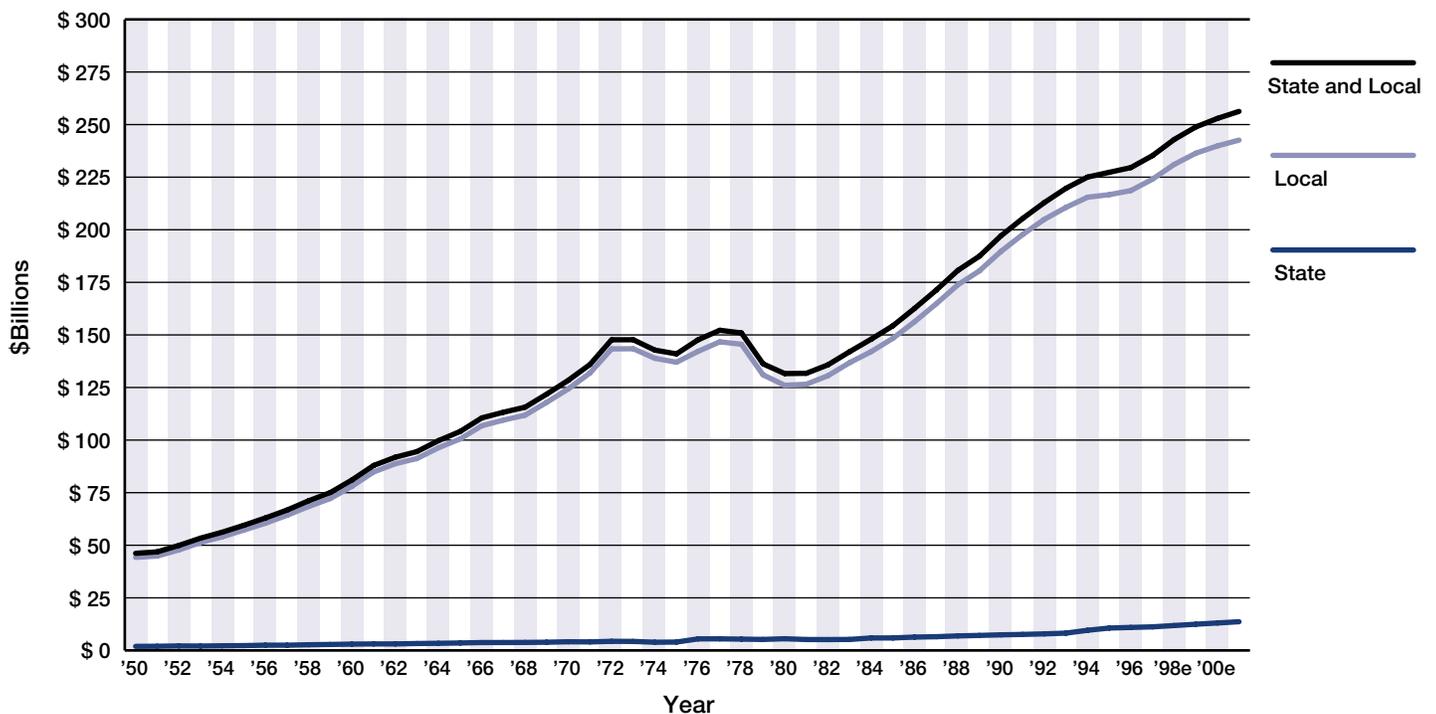*Tax Foundation*

Introduction

The property tax has been an enigmatic issue among economic and political scholars over the last century. Although the property tax is the principal source of revenue for localities, broad consensus has not been reached on the basic issue of whether property taxes are regressive, proportional or progressive.

This survey of property tax collections also provides the reader with a basic under-standing of property tax administration, as well as a primer on current economic thinking about how the property tax affects taxpayers and the economy.

First, a discussion of current property tax data includes aggregate collections and state-by-state comparisons. A brief discussion of property tax administration focuses on assessment issues. Finally, general theories of property taxation are presented, along with a brief discussion of the possible policy implications.

Figure 1
State and Local Property Tax Collections in Constant 2001 Dollars
Fiscal Years 1950–2001

Source: Department of Commerce, Bureau of the Census.

Year	State and Local	State	Local
1932	$ 49,178	$ 3,595	$ 45,583
1934	43,372	2,905	40,467
1936	42,320	2,357	39,963
1938	45,479	2,499	42,980
1940	$ 44,956	$ 2,639	$ 42,318
1942	40,101	2,333	37,768
1944	37,657	1,988	35,669
1946	35,485	1,772	33,713
1948	37,094	1,671	35,423
1950	$ 46,158	$ 1,928	$ 44,229
1951e	46,866	1,983	44,883
1952	49,908	2,134	47,774
1953	53,377	2,078	51,298
1954	56,193	2,204	53,994
1955	$ 59,482	$ 2,283	$ 57,199
1956	62,968	2,503	60,465
1957	66,725	2,485	64,240
1958	71,144	2,699	68,444
1959	75,052	2,835	72,217
1960	$ 81,027	$ 2,998	$ 78,029
1961	87,924	3,082	84,837
1962	91,835	3,085	88,750
1963	94,509	3,278	91,230
1964	99,744	3,390	96,353
1965	$ 104,083	$ 3,530	$ 100,553
1966	110,541	3,737	106,804
1967	113,239	3,748	109,496
1968	115,630	3,801	111,830
1969	121,847	3,897	117,950
1970	$ 128,435	$ 4,118	$ 124,320
1971	135,930	4,044	131,886
1972	147,684	4,330	143,355
1973	147,709	4,280	143,426
1974	142,776	3,894	138,883
1975	$ 140,980	$ 3,973	$ 137,007
1976	147,691	5,488	142,205
1977	152,220	5,502	146,718
1978	150,940	5,372	145,568
1979	136,227	5,223	131,002
1980	$ 131,618	$ 5,557	$ 126,061
1981	131,740	5,182	126,558
1982	135,767	5,155	130,613
1983	142,017	5,221	136,798
1984	147,980	5,925	142,055
1985	$ 154,319	$ 5,925	$ 148,392
1986	162,574	6,338	156,237
1987	171,262	6,517	164,750
1988	180,656	6,899	173,795
1989	187,427	7,130	180,460
1990	$ 197,147	$ 7,409	$ 189,738
1991	205,361	7,612	197,749
1992	212,913	7,868	204,930
1993	219,707	8,219	210,621
1994	225,045	9,573	215,471
1995	$ 227,301	$ 10,634	$ 216,667
1996	229,546	10,931	218,616
1997	235,247	11,202	224,046
1998e	242,900	11,836	231,048
1999e	248,866	12,458	236,383
2000e	$ 252,924	$ 13,045	$ 239,853
2001e	256,275	13,644	242,625

Note: Estimates based on yearly property tax growth as reported in NIPA.
Source: Department of Commerce, Bureau of Economic Analysis and Bureau of the Census.

Total Collections

In 2001, state and local governments across the United States will collect an estimated $256 billion in property taxes.[1] Approximately 95 percent of this total, $243 billion, will be collected by local government units including counties, cities, and school districts.

Property Taxes Since 1950

As shown in Figure 1 and Table 1, property tax collections (adjusted for inflation) in the United States have been rising steadily since 1950, with one notable exception. A series of tax revolts in the 1970s, epitomized by California's Proposition 13, caused property tax collections to level out and for a handful of years to decline. However, since 1980 when the drop in property tax collections bottomed out, total property taxes have climbed 95 percent in real terms.

The 1950s and 1960s

Between 1950 and 1972, state and local property tax collections increased at an average rate of 5.7 percent per year, adjusting for inflation. In comparison, national income only increased an average of 3.8 percent per year over this period.[2]

The Tumultuous 1970s

After 1972, a growing wave of anti-tax sentiment resulted in a halting, and a temporary reversal, of the annual increases in property tax collections. By 1977, however, property tax collections had rebounded to their 1972 level. The anti-tax movement reached another milestone in 1978 when California passed Proposition 13. Proposition 13 amended the state's constitution to impose strict limits on local property tax rates and the growth in property tax revenues. Real property tax collections throughout the United States dropped rapidly after 1978. By 1980, when the drop had bottomed out, state and local property tax collections were 13 percent lower in real dollars than they had been two years earlier.

A powerful motivation for those who led the California revolt and the anti-tax move-

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[1] Due to the four-year lag in available data, state and local property taxes for FY 1998 to FY 2001 were estimated using data from the National Income and Product Accounts.

[2] National income here refers to Net National Product (NNP) from the National Income and Product Accounts published by the Bureau of Economic Analysis, Department of Commerce.

ment in general was the rapid rise in home values fueled by the high inflation of the late 1970s. Naturally, higher home values resulted in rising property tax burdens. This rise was politically troubling because inflation generally affects everyone equally, thereby pushing up tax burdens without regard to "ability to pay." In response, many states have adopted targeted tax relief in the form of "circuit breakers" and "homestead" exemptions on residential property taxes.

The Last 20 Years

Since 1981 property tax collections have resumed the rapid increase that existed before the anti-tax movements in the 1970s. By 1985, property tax collections had surpassed the record high set in 1977. This growth has continued unabated throughout the late 1980s and 1990s. Between 1980 and 2001 state and local property taxes have increased at an average annual rate of 3.2 percent after adjusting for inflation. This compares with a 3.0 percent annual growth rate for national income.

State Property Taxes

Figure 2 shows that property tax collections accounted for only 2 percent of state government tax collections in 1997. States generally rely on other tax sources to finance their activities such as sales and excise taxes (49 percent of total revenues) and income taxes (33 percent). Nevertheless, 39 states collected over $10 billion in property taxes in FY 1997, and a few states collected surprisingly high amounts.
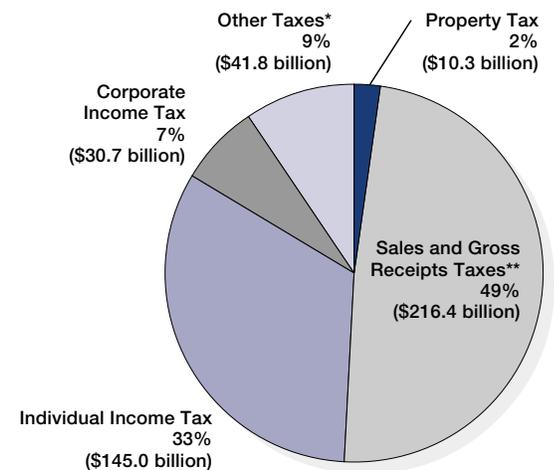
Table 2 shows state property tax collections by state and ranks those collections per capita and per $1,000 of personal income. In per capita terms, six states collected more than $100 in property taxes. In a league by itself is Washington State with per capita prop-
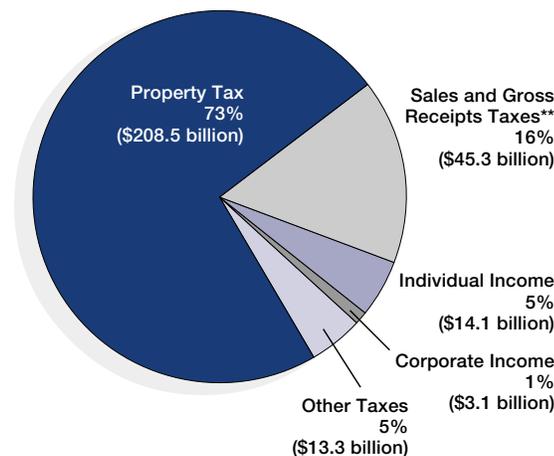
When comparing state-level property tax collections in 1997, Washington State was in a league of its own, with revenue amounting to $347 per capita.

erty tax collections of $347. The other five are Montana ($268), Wyoming ($178), Michigan ($173), California ($113), and Kentucky ($107). In terms of personal income, only two states collected more than $10 per $1,000 of personal income: Montana ($14) and Washington ($13).

Table 4 shows the average annual growth rates, adjusted for inflation, of per capita state property tax collections by state over the past ten years. While starting from a low base, the three states with the fastest growing property tax collections are Mississippi (50.1 percent), Vermont (31.1 percent) and New Mexico (22.9

Figure 2
State and Local Government Tax Collections by Source
Fiscal Year 1997
($Billions)

State Government Taxes

Other Taxes* 9% ($41.8 billion)

Property Tax 2% ($10.3 billion)

Corporate Income Tax 7% ($30.7 billion)

Sales and Gross Receipts Taxes** 49% ($216.4 billion)

Individual Income Tax 33% ($145.0 billion)

Local Government Taxes

Property Tax 73% ($208.5 billion)

Sales and Gross Receipts Taxes** 16% ($45.3 billion)

Individual Income 5% ($14.1 billion)

Corporate Income 1% ($3.1 billion)

Other Taxes 5% ($13.3 billion)

* "Other" is Motor Vehicle Licenses and numerous small revenue sources.

** Includes general sales tax as well as selective excise taxes on products and services such as motor fuel, tobacco, alcohol and public utilities.

Source: Department of Commerce, Bureau of the Census.

Table 2
State Property Tax Collections Per Capita and Per $1,000 of Personal Income and Corresponding Ranks
Fiscal Year 1997

				Rank	
State	Total ($Thousands)	Per Capita (a)	Per $1,000 of Personal Income (a)	Per Capita (a)	Per $1,000 of Personal Income (a)
All States (b)	$ 10,302,904	$ 39	$ 2	-	-
Alabama	$ 131,229	$ 30	1	13	12
Alaska	53,567	88	3	7	7
Arizona	256,879	57	3	8	8
Arkansas	8,355	3	0	26	24
California	3,611,595	113	4	5	6
Colorado	-	-	-	-	-
Connecticut	$ 12	$ 0	$ 0	38	38
Delaware	-	-	-	-	-
Florida	787,614	54	2	9	9
Georgia	38,155	5	0	22	22
Hawaii	-	-	-	-	-
Idaho	-	-	-	-	-
Illinois	$ 204,263	$ 17	$ 1	16	18
Indiana	4,203	1	0	33	33
Iowa	-	-	-	-	-
Kansas	$ 43,804	$ 17	$ 1	18	16
Kentucky	414,857	107	5	6	5
Louisiana	25,324	6	0	21	21
Maine	42,216	34	2	12	11
Maryland	236,099	47	2	10	10
Massachusetts	$ 128	$ 0	$ 0	37	37
Michigan	1,688,279	173	7	4	4
Minnesota	9,748	2	0	30	31
Mississippi	22,816	8	0	20	20
Missouri	15,532	3	0	29	29
Montana	$ 234,906	$ 268	$ 14	2	1
Nebraska	4,923	3	0	28	28
Nevada	61,293	37	1	11	13
New Hampshire	588	1	0	34	34
New Jersey	2,540	0	0	35	35
New Mexico	$ 39,600	$ 23	$ 1	14	14
New York	-	-	-	-	-
North Carolina	-	-	-	-	-
North Dakota	2,212	3	0	25	25
Ohio	17,614	2	0	31	32
Oklahoma	-	-	-	-	-
Oregon	$ 79	$ 0	$ 0	36	36
Pennsylvania	203,497	17	1	17	17
Rhode Island	4,115	4	0	23	26
South Carolina	13,604	4	0	24	23
South Dakota	-	-	-	-	-
Tennessee	-	-	-	-	-
Texas	-	-	-	-	-
Utah	-	-	-	-	-
Vermont	$ 10,296	$ 18	$ 1	15	15
Virginia	$ 21,600	$ 3	$ 0	27	27
Washington	1,926,666	347	13	1	2
West Virginia	2,780	2	0	32	30
Wisconsin	76,345	15	1	19	19
Wyoming	85,571	178	8	3	3
District of Columbia	-	-	-	-	-

(a) Population and personal income figures adjusted into state fiscal years.
(b) Does not include the District of Columbia.
Note: An entry of $0 refers to a positive but insignificant amount of revenue.
Source: Department of Commerce, Bureau of the Census.

percent). On the flip side, the three states with the steepest declines in their state-level property tax collections were New Hampshire (–26.5 percent), New Jersey (–24.3 percent) and Indiana (–22.9 percent).

Local Property Taxes

Figure 2 shows that while property tax collections are fairly insignificant at the state level, they are the single largest source of revenue for local governments in the United States. In 1997, the most recent data available, property tax collections represented 73 percent of all local tax collections. Coming in at a

> *Localities in New Jersey collected more property taxes per capita than the localities of any other state — $1,591 for every man, woman and child in the state.*

distant second were sales tax revenues (16 percent of total revenues) followed by income tax revenues (5 percent).

Table 3 shows local property tax collections by state and ranks those collections per capita and per $1,000 of personal income. Local governments in New Jersey collect the highest amount per capita with property tax collections of $1,591 for every man, woman and child in the state. Following New Jersey localities are New Hampshire localities ($1,555) and Connecticut localities ($1,500). In terms of personal income, New Hampshire localities top the list with $58 collected for every $1,000 of personal income. Following New Hampshire are Maine ($55) and Vermont ($53).

Table 4 shows the average annual growth rates, adjusted for inflation, of per capita local property tax collections by state. Between 1987 and 1997, the three states with the fastest growing local property tax collections are Maine (5.2 percent), Indiana (4.7 percent) and Kentucky (4.7 percent). On the flip side, the three states with the largest declines in local property tax collections were Wyoming (–6.3 percent), Michigan (–3.2 percent) and Oregon (–1.9 percent).

State	Total ($Thousands)	Per Capita (a)	Per $1,000 of Personal Income (a)	Rank Per Capita (a)	Rank Per $1,000 of Personal Income (a)
All States (b)	$ 207,824,892	$ 783	$ 31	-	-
Alabama	$ 904,159	$ 210	$ 10	50	50
Alaska	634,713	1,046	39	10	10
Arizona	2,727,267	607	27	32	30
Arkansas	807,537	321	16	47	45
California	19,589,445	612	23	31	36
Colorado	$ 2,966,595	$ 770	$ 28	22	28
Connecticut	4,902,252	1,500	43	3	7
Delaware	341,740	467	17	41	44
Florida	11,542,524	793	32	17	23
Georgia	4,908,319	662	28	29	29
Hawaii	$ 607,265	$ 512	$ 20	40	42
Idaho	711,346	593	29	33	26
Illinois	12,710,955	1,061	38	9	11
Indiana	5,087,780	869	37	14	12
Iowa	2,319,279	813	35	16	15
Kansas	$ 2,045,364	$ 784	$ 33	20	21
Kentucky	1,113,051	286	14	48	49
Louisiana	1,409,840	324	16	46	47
Maine	1,479,396	1,190	55	7	2
Maryland	3,608,286	711	25	27	33
Massachusetts	$ 6,612,387	$ 1,084	$ 36	8	14
Michigan	6,025,927	617	25	30	34
Minnesota	4,268,684	915	34	13	18
Mississippi	1,234,347	454	25	42	35
Missouri	2,789,181	518	22	38	40
Montana	$ 590,177	$ 672	$ 34	28	19
Nebraska	1,589,279	962	40	12	9
Nevada	936,819	573	21	35	41
New Hampshire	1,814,598	1,555	58	2	1
New Jersey	12,775,758	1,591	50	1	4
New Mexico	$ 485,206	$ 283	$ 14	49	48
New York	24,121,718	1,329	44	4	6
North Carolina	3,806,521	517	22	39	39
North Dakota	462,706	721	34	26	16
Ohio	8,339,499	745	31	23	24
Oklahoma	$ 1,095,421	$ 332	$ 16	45	46
Oregon	2,533,088	787	32	19	22
Pennsylvania	8,805,983	732	29	24	27
Rhode Island	1,217,099	1,233	48	5	5
South Carolina	2,081,688	553	26	36	31
South Dakota	$ 532,956	$ 729	$ 33	25	20
Tennessee	2,333,412	436	19	43	43
Texas	16,348,847	852	36	15	13
Utah	1,097,907	537	26	37	32
Vermont	711,883	1,212	53	6	3
Virginia	$ 5,227,446	$ 780	$ 30	21	25
Washington	3,282,570	591	23	34	37
West Virginia	764,113	420	22	44	38
Wisconsin	5,144,206	992	41	11	8
Wyoming	378,353	788	34	18	17
District of Columbia	$ 699,524	$ 1,311	$ 37	-	-

(a) Population and personal income figures adjusted into state fiscal years.
(b) Does not include the District of Columbia.
Source: Department of Commerce, Bureau of the Census.

Property Tax Administration

The property tax is a tax on the market value of privately owned property, which may include land, structures, machinery and other real property, such as cars, boats, business inventory, etc. Property tax liability is calculated by multiplying the nominal property tax rate by the assessment ratio (the percentage of the value of the property that is taxed) by the value of the property.

For example, if the nominal tax rate is 2 percent, the assessment ratio 50 percent and the assessed value of property $100,000, then the property tax due would be 2% x 50% x $100,000, or $1,000. The product of the nominal tax rate and the assessment ratio is called the effective property tax rate because it represents the actual percentage of the market value of property that is taken in taxes each year. (In the example above, the effective property tax rate would be 2% x 50%, or 1%).[3]

The determination of property values is the responsibility of a designated, government-run assessment agency, which is governed by either elected or appointed officials.

Tax Assessment Ratios

An interesting feature of property taxation is the decision by thousands of localities to tax just a fraction of each property's assessed value, as opposed to the full value of the property. The percentage they choose to tax varies tremendously, and Table 5, a list of property tax rates in each state's largest city, attests to this fact.

In some states, the fractional assessment ratio is a constitutional requirement. Several constitutions set a maximum assessment of 100 percent, and several set lower maximums. Michigan and Washington set a maximum assessment of 50 percent of fair market value. Oklahoma's is 35 percent, and Louisiana's is 10 percent.

Other state constitutions allow less leeway to localities, requiring a certain percentage. South Carolina's 4 percent requirement is based on fair market value, Colorado's 21 percent assessment is based on "actual value," and Florida's 100 percent assessment is based on "just value," which is defined as net cash proceeds to the seller minus selling costs. This turns out to be approximately 85 percent of fair market value.

[3] In many states the property tax rate is expressed as "millage." A mill is one one-thousandth of a dollar, so if the millage is .032, the tax rate is 3.2 percent. "Total millage" is the combination of several overlapping tax jurisdictions, such as county, municipality, school district, etc.

Table 4
State and Local Property Tax Collections Per Capita in Constant 2001 Dollars and Average Annual Growth Fiscal Years 1987 and 1997

	State			Local		
State	1987	1997	Average Annual Growth 1987–1997	1987	1997	Average Annual Growth 1987–1997
All States (a)	$ 28	$ 42	4.2%	$ 685	$ 842	2.1%
Alabama	$ 24	$ 33	3.0%	$ 155	$ 226	3.8%
Alaska	266	95	– 9.8	1,352	1,124	– 1.8
Arizona	49	61	2.3	633	653	0.3
Arkansas	3	4	0.4	280	345	2.1
California	87	121	3.4	604	658	0.9
Colorado	$ 3	-	n.a.	$ 840	$ 828	– 0.1%
Connecticut	-	$ 0	n.a.	1,200	1,613	3.0
Delaware	-	-	n.a.	349	503	3.7
Florida	27	58	8.0%	634	853	3.0
Georgia	4	6	3.0	499	712	3.6
Hawaii	-	-	n.a.	$ 465	$ 550	1.7%
Idaho	-	-	n.a.	475	638	3.0
Illinois	$ 28	$ 18	– 4.0%	773	1,140	4.0
Indiana	10	1	– 22.9	589	934	4.7
Iowa	-	-	n.a.	841	874	0.4
Kansas	$ 18	$ 18	0.2%	$ 791	$ 843	0.6%
Kentucky	96	115	1.8	193	307	4.7
Louisiana	8	6	– 2.5	287	349	2.0
Maine	10	37	14.0	768	1,279	5.2
Maryland	40	50	2.1	622	764	2.1
Massachusetts	-	-	n.a.	$ 898	$ 1,165	2.6%
Michigan	$ 43	$ 186	15.7%	921	664	– 3.2
Minnesota	2	2	0.8	816	983	1.9
Mississippi	0	9	50.1	338	488	3.7
Missouri	3	3	1.1	391	557	3.6
Montana	$ 73	$ 288	14.7%	$ 864	$ 723	– 1.8%
Nebraska	3	3	0.0	898	1,034	1.4
Nevada	56	40	– 3.2	468	616	2.8
New Hampshire	12	1	– 26.5	1,239	1,672	3.0
New Jersey	6	0	– 24.3	1,201	1,710	3.6
New Mexico	$ 3	$ 25	22.9%	$ 216	$ 304	3.5%
New York	-	-	n.a.	1,129	1,429	2.4
North Carolina	18	-	n.a.	400	555	3.3
North Dakota	4	4	– 1.9	565	775	3.2
Ohio	2	2	– 2.3	588	800	3.1
Oklahoma	-	-	n.a.	$ 349	$ 357	0.2%
Oregon	-	-	n.a.	1,024	846	– 1.9
Pennsylvania	$ 16	$ 18	1.0%	574	787	3.2
Rhode Island	10	4	– 8.0	922	1,325	3.7
South Carolina	4	4	0.8	419	594	3.6
South Dakota	-	-	n.a.	$ 716	$ 784	0.9%
Tennessee	-	-	n.a.	362	469	2.6
Texas	-	-	n.a.	796	916	1.4
Utah	-	-	n.a.	566	577	0.2
Vermont	$ 1	$ 19	31.1%	1,086	1,303	1.8
Virginia	$ 6	$ 3	– 4.9%	$ 612	$ 839	3.2%
Washington	282	373	2.8	421	635	4.2
West Virginia	1	2	5.9	305	452	4.0
Wisconsin	30	16	– 6.1	853	1,066	2.3
Wyoming	284	192	– 3.8	1,247	847	– 3.8
District of Columbia	-	-	n.a.	$ 1,209	$ 1,410	1.5%

(a) Does not include the District of Columbia.
Note: An entry of $0 refers to a positive but insignificant amount of revenue.
Source: Department of Commerce, Bureau of the Census.

Table 5
Residential Property Tax Rates in the Largest City in Each State 1999

Rank	City	State	Nominal Rate Per $100	Assess-ment Level	Effective Rate Per $100
1	Bridgeport	CT	$ 6.50	70.0%	$ 4.55
2	Newark	NJ	24.53	14.7	3.60
3	Providence	RI	3.34	100.0	3.34
4	Manchester	NH	3.09	101.0	3.12
5	Houston	TX	2.84	100.0	2.84
6	Milwaukee	WI	$ 2.84	93.3%	$ 2.65
7	Philadelphia	PA	8.26	32.0	2.64
8	Portland	ME	2.53	100.0	2.53
9	Des Moines	IA	4.46	56.5	2.52
10	Sioux Falls	SD	2.79	85.0	2.37
11	Baltimore	MD	$ 5.82	40.0%	$ 2.33
12	Jacksonville	FL	2.13	100.0	2.13
13	Burlington	VT	2.20	92.3	2.03
14	Fargo	ND	49.32	4.1	2.02
15	Detroit	MI	5.68	34.5	1.96
16	Atlanta	GA	$ 4.83	40.0%	$ 1.93
17	Omaha	NE	1.91	96.0	1.83
18	Boise	ID	1.81	98.1	1.77
19	Anchorage	AK	1.82	95.0	1.72
20	Billings	MT	2.12	81.3	1.72
21	Jackson	MS	$ 17.00	10.0%	$ 1.70
22	New Orleans	LA	16.97	10.0	1.70
23	Phoenix	AZ	16.76	10.0	1.68
24	Columbus	OH	5.63	29.7	1.67
25	Memphis	TN	6.31	25.0	1.58
26	Portland	OR	$ 2.03	76.4%	$ 1.55
27	Salt Lake City	UT	1.49	99.0	1.48
28	Indianapolis	IN	9.50	15.0	1.43
29	Columbia	SC	35.43	4.0	1.42
30	Boston	MA	1.34	100.0	1.34
31	Louisville	KY	$ 1.33	100.0%	$ 1.33
32	Witchita	KS	11.30	11.5	1.30
33	Minneapolis	MN	1.46	88.3	1.29
34	Seattle	WA	1.31	89.9	1.18
35	Little Rock	AR	6.30	18.3	1.15
36	Charlotte	NC	$ 1.20	94.1%	$ 1.13
37	Oklahoma City	OK	10.21	11.0	1.12
38	Virginia Beach	VA	1.22	91.7	1.12
39	Albequerque	NM	3.37	33.0	1.11
40	Kansas City	MO	5.83	19.0	1.11
41	Las Vegas	NV	$ 3.11	35.0%	$ 1.09
42	Wilmington	DE	2.30	44.4	1.02
43	Washington	DC	0.96	100.0	0.96
44	Chicago	IL	9.45	10.0	0.95
45	Charleston	WV	1.51	60.0	0.91
46	New York City	NY	$ 10.88	7.6%	$ 0.83
47	Los Angeles	CA	1.06	75.0	0.80
48	Birmingham	AL	7.72	10.0	0.77
49	Cheyenne	WY	7.73	9.5	0.73
50	Denver	CO	6.89	9.7	0.67
51	Honolulu	HI	$ 0.37	100.0%	$ 0.37
	Unweighted Average		$ 6.80	55.5%	$ 1.69
	Median				$ 1.55

Source: Government of the District of Columbia, Office of Tax and Revenue, Tax and Economic Policy Administration

To make the matter even more confusing to taxpayers in states where localities have a choice, most local tax jurisdictions choose to assess at a lower ratio than the state maximum allows. Obviously, they could achieve the same result in terms of revenue and tax burden by using an assessment ratio of 100 percent (or the state maximum) and adjusting the rate. So why would New York City set an assessment ratio of 7.6 percent and charge $10.88 per $100 of property value, when it

Why would local governments routinely underassess their property? ...Many state and federal programs allocate funds to local governments based on the socio-economic status of their residents, and property value is part of socio-economic status. ...These programs create incentives for localities to make their populations appear less wealthy.

could achieve the same result by doing away with the assessment ratio and simply charging 83¢ per $100 of the property's entire fair market value?

One possible explanation is that the tax-paying public is not as sensitive to changes in assessment ratios. If true, it would follow that politicians encounter less resistance to proposed increases in assessment ratios than to proposed increases in nominal property tax rates. Local officials can then raise revenue and still claim that the property tax rate has not been raised, even though raising the assessment ratio has the same effect.

Assessing Property Value

Traditionally, property has been assessed by local officials, and local political entities collect the taxes. Recently, however, state agencies have become more involved in overseeing the uniform application of assessment policies. This trend is a response to public claims that unequal tax burdens are levied on home owners whose houses have the same value.

For example, if two people in different

localities each own a house worth $100,000 on the open market, and the effective property tax rate in both localities is the same, say 5 percent, then the two home owners should pay the same property tax. However, different assessment procedures in localities could easily result in the valuation of one house at $95,000 and the other at $80,000. While the different assessments definitely raise a fairness issue, notice also that both assessments in this example are below market value. This below-market assessment is one of the hallmarks of local property assessment.

Systemic Underassessment

Why would local governments routinely underassess their property? At least two reasons seem plausible.

Many state and federal programs allocate funds to local governments based on the socio-economic status of their residents, and property value is part of socio-economic status. For example, the State of Maryland allocates funds for education, libraries and police protection partially on the basis of assessed housing value.[4] Similarly, average property values of school districts are taken into account by the State of New Jersey when it allocates education funding. These programs create incentives for localities to make their populations appear less wealthy. The funds obtained from federal and state programs based on lower assessed housing values may even exceed the local property tax revenue lost due to the underassessment of property.

A more obvious reason for local officials to underassess property values is the fact that property owners have the right to petition, in court or before a review board, for a change in the assessed value of their houses if they think the value has been overstated. Therefore, property will almost inevitably be taxed below market value because petitions will correct overestimates but not underestimates, and assessing agencies will seek to avoid the antagonistic process of answering protests by erring on the low side when they assess.

Centralization

A centralizing trend has been developing in the assessment of property and the administrative process of collecting property taxes. This movement is largely a reaction to the aforementioned lack of uniformity in assessment. For example, in Kansas, over the past twenty years the state government has standardized much of

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[4] Conversation with an official of the Maryland Department of Revenue.

the local property tax structure.

In a decision that caused New Hampshire to adopt a state property tax and may lead to the enactment of other new statewide taxes, the New Hampshire Supreme Court ruled that funding local public schools with locally collected property taxes is unconstitutional. The court found that because local property taxes yield significantly different revenue from locality to locality, the resulting pattern of education funding was inherently inequitable.

Centralization of property tax collection has the advantage of eliminating some assessment inequities, but its costs may outweigh its benefits. The more centralized property taxation becomes, the less tax competition exists in

So the dual nature of the property tax, according to traditional theory, is that it includes a progressive tax on land and a regressive tax on structures. Scholars reasoned that since structures have a larger effect on the determination of property value, the property tax is largely regressive.

the political environment. This lack of competition eliminates an otherwise strong incentive for local governments to keep tax rates low so that firms and home owners do not relocate. Of course, even under a centralized system with uniform assessment procedures and a single statewide property tax rate, the incentive to relocate would still strengthen as taxes rise, but with no in-state competition, out-of-state destinations would become more popular.

Three Economic Views of the Property Tax

Economists have specific "classifications" for different types of taxes, and much of the debate over the property tax stems from deciding into exactly which of these classes the property tax falls. This is important because different classifications imply different economic effects from changes in policy. There are three primary schools of thought on the classification of the property tax. These are defined here as the "traditional" or orthodox view, the "new view," and the "benefit" view.

Traditional theory views the property tax as a tax on profits because property has the purpose of providing its owner a return on his investment. This return is often monetary but may also save its owner time or provide other valuable conveniences. The tax on land is seen as having different effects from the tax on structures.

The "new view" theory ignores the distinction between land and structures, reasoning that the property tax is equivalent to a general tax on capital.

Finally, recent scholarship in benefit theory has evaluated the property tax as not being a tax at all. Rather, the property tax is seen as a purchase price for the bundle of goods and services provided by the local government in that district such as schools, parks, police and fire protection.

Traditional/Orthodox Theory

The traditional theory divides the property tax into two components, a tax on the return on land and a tax on the return on structures.

Taxing Land

Since the amount of land is fixed, and immobile, its owners are unable to respond to increases in taxes by moving their land to another place. Therefore, a rising property tax has no effect on the supply of land and reduces the returns to land by taking part of the revenue it generates.

Farmers and landlords illustrate the principle. Both receive revenue by gainfully employing their property. When the property tax increases, after-tax profits decrease, lessening the value of the property. Since the businesses are dependent on the land, which cannot be relocated, both the landlord and farmer pay increased taxes, receive reduced profits and own land of less value.

Moreover, the traditional theory holds that these landowners will absorb the full cost of the tax, and pass none of it onto consumers in higher prices. This is because the farmer and the landlord were already maximizing their profits, and if they raise their prices they will only end up with less after-tax income than if they kept doing what they had previously. Customers and tenants, therefore, are unaffected by the property tax increase. See Rosen [1990]. Since land ownership tends to increase with income, this part of the traditional theory predicts that the property tax is progressive.

Taxing Structures

The property tax as it relates to structures is quite different. Given a long enough period

of time, structures are mobile. This does not mean that grain silos and apartment buildings can be moved, but instead that investors can respond to changes in cost and alter their decisions about where to build future structures based on expected after-tax returns.

The "new view" looks at the property tax as a general tax on capital. ... Since capital ownership as a percentage of wealth increases with income, this tax on capital will fall more heavily on the wealthy, making it a progressive tax.

When the property tax increases, barely profitable investments become unprofitable and therefore are not undertaken, at least not in the high-tax region.

What happens, then, to consumers and prices? Because of the lower after-tax return to capital and the ability of investors to lower the supply of capital in the long run, firms will raise prices and pass much of the burden of the increased tax onto consumers. Since own-

The benefit view indicates that the property tax is generally proportional because the cost is offset by received benefits. However, evidence reveals that benefits received decrease as income rises, suggesting a progressive element.

ers of structures pass the property tax burden onto consumers in this case, the tax on structures likely has regressive characteristics. See Aaron [1975].

So the dual nature of the property tax, according to traditional theory, is that it includes a progressive tax on land and a regressive tax on structures. Scholars reasoned that structures have a larger effect on property value, and that therefore the property tax is largely regressive. This theory was reinforced by data in many studies such as Netzer [1957], Pechman-Okner [1966] and Musgraves [1968].

The "New View"

The "new view" proposed by Mieszkowski [1972] abandons the traditional view's method of breaking the property tax down into two parts. Rather, since the property tax is a tax on land, buildings, and other capital equipment, the new view looks at the property tax as a general tax on capital. Furthermore, it speculates that capital is relatively fixed in supply. The more fixed the supply of a good, the more the burden of a tax falls on the owner/producer of that good. Capital ownership as a percentage of wealth increases with income. Therefore, the new view predicts that the tax on capital will fall more heavily on the wealthy, making the property tax a progressive tax.

The Benefit Theory

The benefit theory was first introduced by Charles Tiebout in 1956, and it interprets the property tax as the cost of receiving public goods and services provided by a locality. This includes schooling, fire and police protection, public transportation, etc.

Thus, two factors that go into buying a house are the local public services provided, and the cost of these services, i.e. the property tax. Different localities present different combinations of costs and benefits associated with local public services. Home owners and businesses locate where they find their personal preferences best suited.

This theory was reinforced in a paper by Wallace Oates (1969) that found property values increased as the quality of public services increased and decreased as property taxes became higher. The Oates study illustrated that home owners are willing to pay a higher price for better public services.

The benefit theory also implies that as property taxes rise, so do valuable public services. However, it can be plausibly argued that many local public services like schooling and public transportation primarily serve individuals at the lower end of the income scale, while taxpayers with high property values are bearing the increased tax burden.

An example of the tension created by this redistribution is the current dispute in Los Angeles, where the relatively wealthy residents of the San Fernando Valley have discussed seceding from the city because of high taxes. Furthermore, there is dispute over whether higher spending necessarily correlates with better public services. See, for example, Hederman [2001].

Therefore, the benefit view indicates that the property tax is a generally proportional tax because the cost is offset by received benefits.

However, evidence reveals that benefits received decrease as income rises, suggesting a progressive element.

Combining the New View with the Benefit View

In most cases the three theories are not mutually exclusive. It is probable that all the effects discussed do occur to some degree. The question is which effects dominate.

In recent years, the economic literature has clearly moved toward the "new view" and benefit theories. They reveal the income distri-

Instead of looking at the property tax as a tax, the "benefit" theory states that the property tax represents the cost of receiving public goods and services provided by a locality. This includes schooling, fire/police protection, public transportation, etc.

bution of the property tax burden as at least proportional and probably progressive. See, for example, Paul [1975] and Aaron [1975].

Economic Cost

We have discussed the likely distribution of the burden imposed by a property tax increase and determined it to be roughly progressive in nature. However, it is also important to investigate how the enactment of legislation changes the incentive structure within the marketplace.

Lower Living Standards

As was incorporated into the models discussed earlier, a property tax increase, by taxing land, buildings and productive machinery acts as a tax on capital profit, thereby reducing returns. For example, imagine a simple world with only two cities. Both initially have no property tax and investors find they can get 10-percent returns on their investment capital. One day Town A decides to institute a 5-percent property tax, creating a 5-percent difference in after-tax profits between Town A and

Town B. This difference provides an incentive over time for firms to move capital out of Town A and into Town B. This would continue until after-tax capital returns are relatively equal in the two areas, somewhere between 5 percent and 10 percent. This convergence would occur because the increasing number of suppliers (firms, the capital owners) in Town B will put downward pressure on profits there. Therefore, the property tax increase not only has the effect of decreasing profits in Town A, but it also decreases profits of firms in Town B. Thus, it is evident that the imposition of a property tax in one region has an economic impact on other localities.

A central assumption of this analysis is that capital is mobile. Though there is debate over just how mobile it is, most economists agree that capital is mobile enough for the dynamics discussed to take place in the mid-to-long run. Furthermore, it is reasonable to assume that capital becomes more mobile as technology advances. For instance, it is easier for a software firm to relocate than a manufacturing plant. This implies that the effects described above have become more relevant as technology has improved.

Taxpayer Flight

Considering the effect of property taxes on business profits is important because firms pay wages and provide goods and services to the public. Inevitably, financial difficulties felt by firms are passed onto consumers in the form of lower wages and/or higher prices. Moreover, the imposition of property taxes means that less money will be available to invest in the processes of innovation and discovery that increase the standard of living.

The effect of the property tax on home owners goes beyond the immediate impact of lower wages, higher prices, and reduced capital discussed above. Also of concern are the direct effects of increased taxes and the perceived quality of public services.[5] Given the property exemption structure that lessens the taxation of the poor and the concentration of the benefits of local public services at the lower end of the income scale, many property tax payers see little benefit from a property tax increase. In this case the increase in property taxes, especially for more wealthy home owners, increases the tax burden in that locality relative to others, providing incentives to

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[5] The direct effect of the property tax on home owners is related to the efficiency with which the locality uses public funds, and how local public services cater to the needs of the homeowner. For example, retirees do not receive as much benefit from an increase in school funding as do parents with school age children. The discussion in this section assumes that the marginal quality of public services remains constant as spending increases.

move elsewhere.

This is a potential factor contributing to the increased suburbanization observed in recent history. The increased cost of local public services in cities, which provided aid primarily to those in poverty, caused those who did not receive as much benefit from the increase in services to move elsewhere. This resulted in an erosion of the property tax base

Exemptions and circuit breakers built into the property tax structure, which were created in order to provide relief for a regressive tax system, are not well grounded in contemporary evidence and theory.

and in many cases financial problems that have persisted to this day (often resulting in the creation of new taxes or the increase of old ones).

Misallocation of Resources

The effects of the benefits theory are also evident among home owners. Raising the property tax causes an increase in the cost of owning a house. This increase in the price of home ownership will not only be nominal but relative to other goods and services. This will in turn affect the mix of goods and services home owners decide to buy, thereby moving consumption from housing to other goods and services. For firms this effect may manifest itself in less investment in capital subjected to the property tax and more investment in other capital, such as intellectual and foreign capital. In both the case of home owners and firms, the imposition of a property tax causes a misallocation of capital.

Home owners and the collection of individuals that make up firms are rational entities. Given enough time, they are both able to react to changes in property taxes in order to benefit themselves. Such tax-induced actions, although completely rational, have negative effects on the economy and long-term standards of living. Policy makers, when considering a property tax increase, often ignore these

costs and consider only the benefit side of the issue.

Conclusion

First, this paper provides the reader with recent data on state and local property tax collections as well as a sample of rates in major American cities.

Second, a general discussion of property tax administration includes commentary on the recent trend toward centralization of the property tax collection process. Though this trend is occurring largely in response to a demand for "tax fairness," the results of the trend are bittersweet because of the elimination of tax competition between localities. Statewide control of assessment and tax rates creates less pressure to keep taxes down and efficiently use tax revenue.

Third, theoretical analysis concludes that the property tax is best explained by combining insights from the "new view" and the benefit theories of property taxation, and that property taxes are at least proportional and probably quite progressive. It follows, therefore, that exemptions and circuit breakers designed to mitigate a regressive tax system— while no doubt appreciated by the taxpayers targeted for relief—are not well grounded in contemporary evidence and theory.[6]

Another policy implication of the hybrid view is that benefits theory is valuable in explaining how the quality of public services provided in a specific locality with a certain effective property tax rate influences individuals' location decisions, as capital moves to low-tax areas and residents move to jurisdictions with a combination of good public services and reasonable taxes.

It also helps explain the willingness of home owners to tolerate high property taxes in areas with good public schools. The value of the public services provided outweighs, for some, the cost of high property taxes.

Finally, it is consistent with the view that a property tax increase inevitably has negative effects on the economy of the locality as well as the national marketplace.

Methodology

This report is based on state-by-state property tax collection data published by the Bureau of the Census. Due to limitations in data availability, state and local property taxes for

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[6] Circuit breakers offer relief to lower income residents through credits on their income tax, credits against their property tax, or cash payments. Homestead exemptions offer relief through the reduction in the assessed taxable base of qualified homeowners' property, such as farm property. The majority of states currently provide tax relief through some combination of circuit breakers and homestead exemptions.

FY 1998 to FY 2000 were estimated using data from the National Income and Product Accounts published by the Bureau of Economic Analysis.

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