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SPECIAL REPORT

Property Taxes on the Rise Again Across Nation

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In 1993, state and local governments across the United States will collect an estimated $193 billion in property taxes. The vast bulk of this, about $186 billion, will be collected by local government units including counties, cities, and school districts.

Property taxes in the United States have been rising steadily since 1980 (see *Figure 1* and *Table 1*). While the tax revolts of the 1970s, led by California's landmark Proposition 13, caused property taxes to level out during that decade, total property taxes paid by Americans are now 62 percent higher, in after-inflation dollars, than they were in 1980.

Due to rapidly rising property taxes, local taxes are now growing faster than state taxes, reversing a trend of faster state tax growth through the 1970s and early 1980s. From 1985 to 1991, local tax revenues rose 60 percent compared to 44 percent for state tax revenues.

Polls consistently show property taxes are the least liked form of taxation. Property taxes have often been poorly administered and subject to political influence, leading to unequal and unfair assessments. In addition, they can be imposed so as to have a regressive impact and they can produce serious economic dislocations such as urban blight.

Despite these problems, property taxes continue to be the primary source of tax revenue for local governments, providing 75 percent of local government tax revenue.

Figure 1
State and Local Property Tax Collections in Constant (1993) Dollars
1960 - 1993

Source: Tax Foundation.

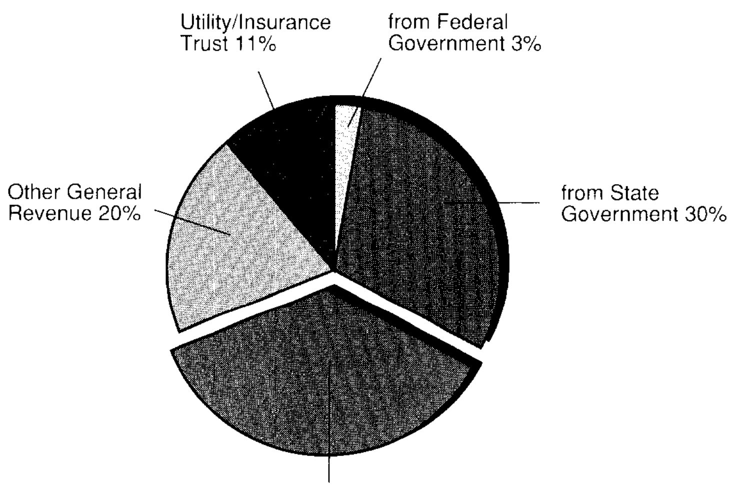
Trends in Property Taxation

In 1980 total property tax revenue in the United States had fallen eight percent below property tax revenue in 1970, in after-inflation figures. This fall in revenue resulted from a wave of anti-tax protest across the nation highlighted by California's Proposition 13, adopted in 1978. Proposition 13 amended the state's constitution to impose strict limits on local property tax rates and the growth in property tax revenues. With Proposition 13, the average effective tax rate fell from 2.5 percent to 1 percent of market value and California's share of the nation's total property taxes fell from 16 percent in 1977 to 10 percent five years later.

Other states followed California's lead and property taxes—which had peaked at $140 billion for the country in 1977—fell to $119 billion by 1980 (both figures in 1993 dollars). State governments in 33 states now place limits on local property tax rates, and 16 state governments place limits on property tax revenues.

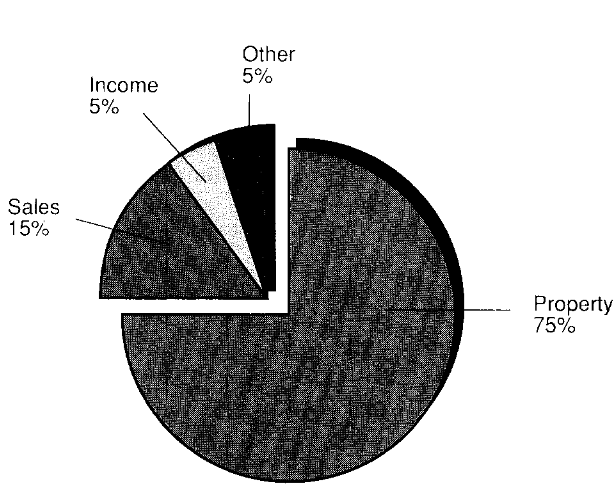
A factor that led to the California revolt was the rapid rise in home values, fueled by the high inflation of the 1970s. In response, many states now tax residential property at lower rates than business property. In addition, states have adopted "circuit breakers" and "homestead" exemptions on residential property taxes. Circuit breakers offer relief to lower income residents, through credits on income tax, credits against the property tax, or cash payments. Homestead exemptions reduce the assessed taxable base of a homeowner's property. Thirty-two states currently have some form of circuit breaker and 18 states provide homestead exemptions.

Figure 2
Local Government Revenue by Source (1991)



Source: U.S. Bureau of Census.

Figure 3
Local Government Tax Revenue by Source (1991)



Source: U.S. Bureau of Census.

Despite the success of the various tax revolts during the 1970s, by 1981 property tax collections were once again rising, as *Table 2* documents. Property taxes per capita increased a staggering 329 percent in the District of Columbia from 1980 to 1991, compared to a national average of 122 percent. (In comparison, over that period the general price level rose only 64 percent.) The District was followed in order by Florida, New Hampshire, Virginia, South Carolina, and New Jersey, which all had per capita property tax increases of over 150 percent.

State Comparisons

Property taxes are levied by 42 state governments. Because state property taxes are typically levied on a narrow base, state governments collected only $6.2 billion from property taxes in 1991, representing just 2 percent of total state government tax revenue. Only three states, Alaska, Washington, and Wyoming, collect over $100 per capita annually in state property taxes.

In contrast, property taxes are the bread and butter of local government finance. Property taxes provide 75 percent of local tax revenue (see *Figures 2* and *3*). According to the latest 1991 Bureau of Census data, local governments in five states and the District of Columbia now average over $1,000 per capita in local property taxes. The District leads the way at $1,475 per person, followed by local governments in New Hampshire, New Jersey, Alaska, Connecticut, and New York (see *Table 3*). In this group, however, New Hampshire stands out because overall it is a low tax state, ranking 33rd in total state and local taxes per capita. In contrast, the other four states and the District all rank in the top ten in terms of total state and local taxes per capita.

Various units of local government may be responsible for property tax hikes. Currently, school districts claim 40 percent of local property taxes, county governments receive 23 percent of local property tax revenue, and municipal governments receive 22 percent (see *Figure 5*). Every year since 1982, county government tax collections have grown more quickly than school district or municipal government collections. County government revenues have been growing quickly because of fast population growth; rapid growth in health and social services spending, on which counties spend more than cities; and because they have increased their areas of responsibility.

Property Tax Administration

Property taxes are levied on both "real" property (land and buildings) and "personal" property. Business personal property (such as machinery and inventory) is taxed in most states, while residential personal property (such as automobiles) and intangible property, in particular financial assets, are taxed only in a minority of states.

Administration of the property tax has always been problematic and subject to controversy. Unlike income and sales taxes, which are levied on economic transactions, it is more difficult to determine the value or base against which to apply property taxes. In fact, this difficulty often leads to large inequities in the tax and makes necessary the complicated administrative process of levy, assessment, review, equalization, and appeals.

Once a local government decides to levy a tax on a certain type of property, an estimate or assessment of the value of the property must be made. Each year in the U.S. property taxes are levied on 118 million units of property for 66,000 different governments. Because there are so many parcels of property, specific valuations are typically only made infrequently. For this reason, assessments typically differ substantially from market prices and vary substantially from one locality to another.

These disparities inevitably lead to unhappy taxpayers, who may see their assessment jump suddenly upon revaluation or may see similar property owners pay substantially less tax. Significant effort is expended, particularly by businesses, in appealing assessments. In addition, business property owners complain that valuations are often made on political and not economic grounds.

Table 1
State and Local Property Tax Collections in the U.S., 1960 - 1993 (1993$)

Year	Collections	Year	Collections	Year	Collections
1960	$77.1	1972	$137.8	1984	$135.6
1961	82.8	1973	139.1	1985	140.3
1962	87.4	1974	135.1	1986	146.3
1963	91.9	1975	134.4	1987	149.9
1964	97.0	1976	137.8	1988	152.0
1965	101.1	1977	140.0	1989	159.6
1966	103.2	1978	130.8	1990	166.3
1967	110.3	1979	121.7	1991	176.2
1968	116.4	1980	118.8	1992	185.0
1969	121.6	1981	121.0	1993	192.8
1970	129.1	1982	126.0		
1971	134.8	1983	130.5		

Source: Tax Foundation.

Table 2
State/Local Property Tax Collections by State Fiscal Years 1980 and 1991

	1980	1991	% Change
Alabama	$79	$171	116%
Alaska	900	1,213	35
Arizona	352	662	88
Arkansas	134	242	81
California	274	639	133
Colorado	329	690	110
Connecticut	473	1,138	141
Delaware	167	311	86
Florida	224	687	207
Georgia	199	506	155
Hawaii	193	430	123
Idaho	227	427	88
Illinois	367	785	114
Indiana	246	571	132
Iowa	360	686	91
Kansas	366	691	89
Kentucky	135	277	105
Louisiana	111	275	148
Maine	319	796	150
Maryland	288	617	114
Massachusetts	555	830	50
Michigan	413	894	116
Minnesota	324	718	122
Mississippi	141	344	144
Missouri	215	377	76
Montana	455	523	15
Nebraska	401	744	86
Nevada	256	456	78
New Hampshire	451	1,341	197
New Jersey	499	1,257	152
New Mexico	142	222	56
New York	501	1,101	120
North Carolina	171	382	124
North Dakota	269	505	88
Ohio	281	541	93
Oklahoma	151	250	66
Oregon	382	877	130
Pennsylvania	249	562	126
Rhode Island	413	880	113
South Carolina	160	423	164
South Dakota	351	580	65
Tennessee	158	329	108
Texas	280	679	143
Utah	235	416	77
Vermont	377	925	145
Virginia	236	638	171
Washington	290	625	116
West Virginia	137	273	99
Wisconsin	361	797	121
Wyoming	552	912	65
District of Columbia	344	1,475	329
U.S. Average	$300	$666	122%

Source: Tax Foundation.

Table 3
State/Local Property Taxes by State
Fiscal Year 1991

	Annual Property Taxes per Capita			Property Taxes as a % of Income			Per capita Rank	Percent of Income Rank
	State	Local	Total	State	Local	Total		
Alabama	$23	$148	$171	0.1%	1.0%	1.1%	50	50
Alaska	149	1,064	1,213	0.7	5.0	5.8	3	2
Arizona	74	587	662	0.4	3.5	4.0	22	14
Arkansas	4	238	242	0.0	1.6	1.7	48	46
California	74	566	639	0.4	2.7	3.1	23	29
Colorado	2	688	690	0.0	3.6	3.6	18	23
Connecticut	0	1,138	1,138	0.0	4.4	4.4	4	12
Delaware	0	311	311	0.0	1.5	1.5	43	49
Florida	32	655	687	0.2	3.4	3.6	19	20
Georgia	4	502	506	0.0	2.9	2.9	32	32
Hawaii	0	430	430	0.0	2.0	2.0	35	41
Idaho	0	427	427	0.0	2.8	2.8	36	34
Illinois	20	766	785	0.1	3.7	3.8	14	17
Indiana	1	570	571	0.0	3.3	3.3	28	25
Iowa	0	686	686	0.0	4.0	4.0	20	15
Kansas	13	678	691	0.1	3.7	3.8	17	18
Kentucky	87	190	277	0.6	1.2	1.8	44	45
Louisiana	11	264	275	0.1	1.8	1.8	45	44
Maine	36	760	796	0.2	4.4	4.6	13	10
Maryland	37	579	617	0.2	2.6	2.8	26	35
Massachusetts	0	830	830	0.0	3.6	3.6	11	21
Michigan	35	859	894	0.2	4.6	4.8	8	8
Minnesota	2	716	718	0.0	3.7	3.8	16	19
Mississippi	9	336	344	0.1	2.5	2.6	41	37
Missouri	2	375	377	0.0	2.1	2.1	40	40
Montana	96	428	523	0.6	2.7	3.3	31	24
Nebraska	1	743	744	0.0	4.2	4.2	15	13
Nevada	27	429	456	0.1	2.2	2.3	34	38
New Hampshire	0	1,341	1,341	0.0	6.2	6.2	1	1
New Jersey	2	1,255	1,257	0.0	4.9	4.9	2	7
New Mexico	14	208	222	0.1	1.4	1.5	49	48
New York	0	1,101	1,101	0.0	4.9	4.9	5	6
North Carolina	14	368	382	0.1	2.2	2.3	39	39
North Dakota	3	502	505	0.0	3.2	3.2	33	26
Ohio	1	540	541	0.0	3.0	3.0	30	30
Oklahoma	0	250	250	0.0	1.6	1.6	47	47
Oregon	0	877	877	0.0	5.0	5.0	10	5
Pennsylvania	13	549	562	0.1	2.8	2.9	29	31
Rhode Island	10	870	880	0.1	4.5	4.6	9	9
South Carolina	3	420	423	0.0	2.7	2.7	37	36
South Dakota	0	580	580	0.0	3.6	3.6	27	22
Tennessee	0	329	329	0.0	2.0	2.0	42	42
Texas	0	679	679	0.0	3.9	3.9	21	16
Utah	0	416	416	0.0	2.8	2.8	38	33
Vermont	17	908	925	0.1	5.0	5.1	6	4
Virginia	3	636	638	0.0	3.2	3.2	24	28
Washington	246	379	625	1.3	1.9	3.2	25	27
West Virginia	1	272	273	0.0	1.9	1.9	46	43
Wisconsin	10	787	797	0.1	4.4	4.4	12	11
Wyoming	174	738	912	1.0	4.4	5.4	7	3
District of Columbia	0	1,475	1,475	0.0	6.1	6.1		
U.S. Average	$25	$641	$666	0.1%	3.4%	3.5%		

Source: Tax Foundation calculations based on Bureau of Census data.

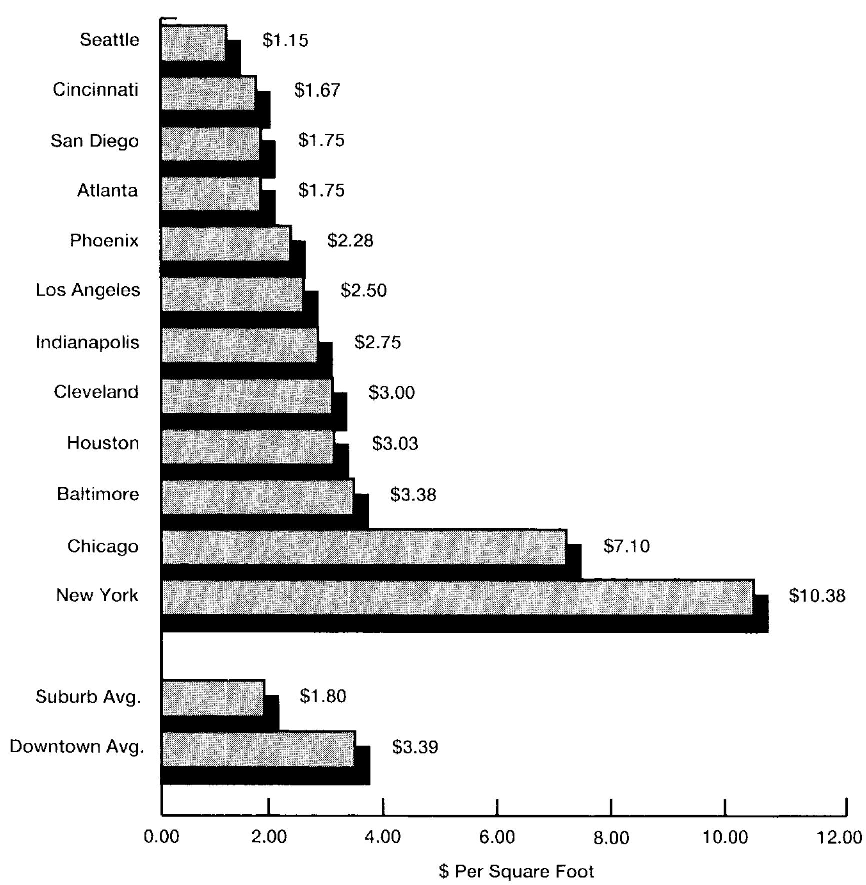
The disparities in assessment also create the need for state government equalization. This is necessary when states dole out aid to local governments based on assessed values or when a property tax at a particular rate is imposed across different locally assessed areas.

The problems with property tax administration are summed up by Brookings Institution tax expert Joseph Pechman:

"Administration of the property tax has been subject to universal criticism. Because the value of the tax base for any particular property cannot be determined directly by a market transaction, property assessments are often arbitrary and result in an erratic distribution of the tax burden . . . . [T]here is great variability in assessments of properties of equal value, creating irritating inequities among taxpayers and among different communities of the same value."

(*Federal Tax Policy*. Brookings Institution, 1987)

Figure 4
Municipal Taxes on Downtown Class A Office Space, mid-1993



Source: CB Commercial Real Estate Group Canada Inc.

Who Bears the Burden of the Property Tax?

Like the corporate income tax, property taxes have a complicated impact on individuals and the economy. Economists have difficulty determining whether property taxes are regressive or progressive—that is, whether they take a larger percentage out of the incomes of the poor or the rich.

Residential property taxes are generally regressive because home values typically represent a smaller percentage of income as incomes rise. A recent study in Wisconsin, for example, found households with incomes up to $15,000 paid 4 percent of their annual income in property taxes, whereas those with incomes greater than $105,000 paid only 1.3 percent of their annual income in property taxes.

It is more complicated to determine the impact of business property taxes. To the extent that property taxes are borne by owners of business property, they are probably progressive since these owners generally are higher income individuals. However, owners may be able to pass property taxes on to users of property, who may then pass the taxes on to consumers in the form of higher prices or to workers in the form of lower wages. To the extent that owners can shift the burden, property taxes on business are regressive. A good example is property taxes paid by landlords, who then pass this cost of business on to renters. Property taxes are then paid by individuals in the form of higher monthly rents in homes and apartments.

Economic Impacts of Property Taxation

Aside from the direct out-of-pocket expenses that property taxes impose, the negative impact that property taxes have on general economic development affects everyone.

The extent of this negative impact is subject to research and controversy. Cities which impose particularly high property taxes depress property values and cause a flight of investment capital. How heavy a burden of property taxation a locality can bear before an area is abandoned by developers and renters depends upon the alternatives these groups have available. The pronounced pattern of higher property taxes in city centers clearly drives businesses out to the suburbs (see *Figure 4*). Indeed, the growth in "edge cities" outside of older city cores is partly the result of this tax flight. When this occurs, the tax base and the value of property falls and the city government often enters a vicious circle of repeatedly raising taxes and driving more businesses and individuals from the city. A recent survey by CB Commercial Real Estate suggests that high business taxes are a prime reason that businesses are abandoning downtown cores and high-tax business centers such as New York City. *Figure 4* illustrates the significant differences in tax rates among major U.S. cities as well as between downtown and suburban office space.

The distinction between "land" and "improvements" is important in examining the impact of property taxes. Since land is relatively fixed in supply, current and future taxes on land values are "capitalized" into lower land prices and are thus paid by land owners at the time the tax was imposed or the tax hike goes into effect.

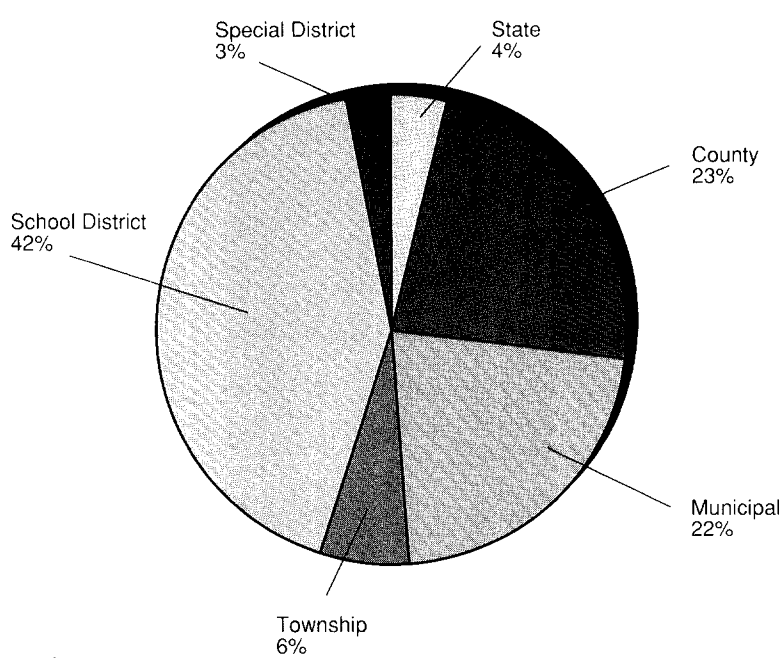
Because property taxes on land are likely to be absorbed by current owners and less likely to drive away new investment, some argue that land, and not improvements, should be the target of property taxation. In contrast, taxes on improvements, such as office buildings and factories, have a larger impact on a local economy as developers and businesses abandon high tax areas. Property taxes on buildings and equipment lead to the deterioration and abandonment of structures, and deter new, better quality construction. As such, high property taxes are a contributing factor to economic deterioration in U.S. cities.

A perverse result of property taxes is that persons or businesses upgrading housing or business property will end up paying *more* towards the cost of local government. Yet newer structures are generally associated with *lower* utilization of local government services such as police, fire, and welfare services. Therefore, property taxes produce a penalty for owners creating a positive benefit for the community by improving their property.

High tax rates on business property cause other problems as well. Competition for businesses and industries between localities have led high tax jurisdictions to frequently offer exemptions and special deals for favored businesses. While many states offer property tax exemptions or incentives to industry generally, 34 states now give incentives targeted to favored industries. But lower rates for some taxpayers can shift higher rates to others, leading to unfairness and an exodus of business and individuals not having political clout.

In addition, high property taxes on businesses create the illusion that government enterprise would be more cost-effective than private business. For example, high tax rates on apartment buildings will reduce the private supply of these structures and lead to calls for government-financed housing. Government-owned enterprises, such housing, also look artificially cheaper when given tax exemptions. Of course, the "savings" thus achieved on these exemptions will result in higher taxes on private business in the jurisdiction.

Figure 5
Property Taxes in the U.S. by Government Unit
Fiscal Year 1991



Source: U.S. Bureau of Census.

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