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Property Tax: Who Pays?

By C. Lowell Harriss, *Economic Consultant, Tax Foundation*

Court decisions about financing public education compel us to reexamine the role of property taxation. Matters of fundamental importance have been raised, extending beyond school costs.

President Nixon, recognizing that the issues transcend the concerns of a few individual states, has asked the nonpartisan Advisory Commission on Intergovernmental Relations to report on three subjects: (1) financing schools, (2) property taxation, and (3) a Federal tax on value added as a revenue source to replace, if such seems desirable, part of the property tax. Meanwhile, the distress of older cities highlights concern about property taxation—revenue adequacy, on the one hand, and, on the other, the effects of the tax on new construction and land use.

What are the present property tax burdens? Who bears them?

Such questions are crucial for making good decisions—to change or not to change. Yet in trying to answer them, one finds that the term "the" property tax embraces widely different elements. (1) Of fundamental significance is the economic difference between (a) land, fixed in supply, and (b) buildings and machinery, the supply of which in a community can be affected by high, as against low tax rates.

(2) Burdens differ greatly. (a) In 1969-70, the per capita tax averaged $168 for the whole country. But note some contrasts, the figures including taxes paid by businesses, public utilities, and farms.

	Per Capita	Per $1,000 of Personal Income
U. S. average	$168	$46
Alabama	39	15
Arkansas	65	25
California	262	63
Connecticut	238	52
District of Columbia	169	34
Hawaii	98	25
Kentucky	69	24
Louisiana	65	23
Massachusetts	250	63
New Jersey	242	57
New York	237	53
Pennsylvania	119	32
South Carolina	60	23
Wisconsin	221	63

Source: U.S. Bureau of Census, Governmental Finances in 1969-70.

In New Orleans property taxation per capita was $63 when (1969-70) the San Francisco figure was $430. Newark's tax per capita was more than three times that of San Antonio. The Chicago (Cook County) tax was $211—Philadelphia County's $107.

(3) Over the state of New York the 1967 Census found farms assessed at 16% of sales price and commercial and industrial properties at 48%. In Massachusetts vacant land was assessed at half the percentage of residential property. And so on.

(4) The same term can mean quite different things when it is applied to both a residential suburb of generally similar properties and a city with widely varied industrial and commercial property. Some localities are new, others old. Some have good assessment. In other places, however, inequalities of assessment are scandalous — sometimes discriminating against residential property and in favor of factories or stores, sometimes favoring homeowners, but generally favoring farms and vacant land.

This Issue in Brief

Sweeping new proposals to change the property tax or substitute other taxes for it raise fundamental questions such as who really pays the burden of the tax, says Dr. Harriss.

Wide contrasts are clear; in the same year New Orleans property taxes per capita were $63 while the burden in San Francisco was $430.

After reviewing estimates of property taxes by income level, Dr. Harriss discusses the effect on capital. He notes the need for more study before decisions are made about what "ought" to be done concerning property taxes. Another article on these taxes will be published in a later issue of **Tax Review.**

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(5) The tax rate has risen considerably in some localities, but in others it has gone up only moderately.

Almost everywhere the tax applies to (1) real property—around 90% of the total—plus (2) (in most states) the machinery, equipment, fixtures, and inventory of businesses. (3) In some cases there is tax on autos but only rarely is there much tax on furniture or other tangible personal property of households. Residential property (nonfarm) accounts for nearly half. Utility property, often assessed by the state, plus other business property accounts for over one third. Farm and vacant land are about one tenth. Of course, the proportions vary widely from place to place.

No longer (with a few exceptions) is there any serious effort to impose a second ("double") tax on intangibles, *i.e.*, on stocks, bonds, bank accounts, mortgage notes, and other "paper" representing tangible property which is taxed where it is located. The homeowner is not taxed on both his house and the deed, the "piece of paper" which has value because it shows ownership of the house. For the same reason, it is not logical to try to tax other intangibles.

The property tax relates to things *(ad rem)*, not to personal conditions *(in personam)*. It is not a tax on income received. Though in one sense a tax on capital, the property tax is not a levy on *net* wealth or *net* worth. This fact applies to both individuals and communities. Debts are not deducted in figuring the amount to be taxed. Property values in different localities do not necessarily indicate the amounts which are owned (net) by residents or companies or others who are expected to bear the tax. For example, the amount of debt that is outstanding against the residences in one community can be substantial, in another much less. The value of services received from the government spending will presumably be the same whether a house has a large or small mortgage.

For the country as a whole estimates of the 1968 property tax burden by income groups are available (See Table 1).

Table 1

Property Tax and Income, Families and Unrelated Individuals, 1968, Percentages[a]

Adjusted Money Income	Property Tax	Property Tax Cumulative	Income	Income Cumulative
	Percentage of Total			
Under $2,000	3.3	3.3	0.8	0.8
$2,000- 3,999	5.9	9.2	2.9	3.7
4,000- 5,999	7.7	16.9	5.9	9.6
6,000- 7,999	10.0	26.9	9.7	19.3
8,000- 9,999	11.3	38.2	11.6	30.9
10,000-14,999	26.7	64.9	27.3	58.2
15,000-24,999	23.1	88.0	23.6	81.8
25,000-49,999	8.2	96.2	11.3	93.1
50,000 and over	3.8	100.0	6.9	10.0

a Assumes that **all** of the tax on business property is shifted to consumers. **All** of the tax on rental housing is assumed to be paid by the occupant. The assumptions are discussed later.

SOURCE: R. A. Herriot and H. P. Miller, "The Taxes We Pay," **The Conference Board Record**, May 1971. Earlier estimates by the Tax Foundation appear in its **Tax Burdens and Benefits of Government Expeditures by Income Class, 1961 and 1965** (1967).

Half of the total tax (49.8%) is shown as borne by the $10,000 to $25,000 income groups—which had half of the total income (50.9%). Over one fifth (22.3%) was borne by the $6,000 to $10,000 groups, which received 21.3% of all income. The two extreme groups shown, having widely different incomes, paid about the same percentages of the total bill—3.3% by those under $2,000 and 3.8% by those with $50,000 and over.

A tax is regressive when the amount borne, presumably in relation to income but perhaps consumption or wealth, is a higher percentage at low than at higher levels. For example, the tax at $6,000 may be $300; at $12,000 it may be $550, and at $24,000 around $1,050. (A proportional tax would be at a uniform rate.) There may be many degrees of regressivity. The same tax may be regressive in some ranges of income, proportional in others, and progressive elsewhere.

The *amount* of burden, of course, will depend heavily on the reliance which a government places on the tax as a revenue source—whether $50 per capita in Birmingham, Ala., or $330 in Boston. At any given income level, the weight of property taxation will differ from one locality to another.

Estimates for 1968 for the country as a whole, by income classes, appear in Table 2. The estimates in the last column are necessarily subject to a wide margin of error; yet they will help to meet a justified criticism of conclusions based on property taxation alone or total taxes without regard for the effects of spending the funds.

But . . . . !! For the property tax, more than perhaps any other, the "true" distribution is probably *not* that which appears. For reasons discussed later, maddening difficulties arise in deciding on how the tax may be shifted by those who make the payments initially, such as the portions on business property and rental housing. Moreover, the best estimate of property tax borne relative to family income cannot deal adequately with the effects today of past changes in property prices which resulted from changes made then in tax rates, "capitalization."

Economic aspects of high significance relate to a feature which grows out of the permanent nature of land (space on the earth's surface) and the long life of some buildings.

A tax on gasoline adds to the price; an income tax reduces the take-home pay. An annual tax on the value

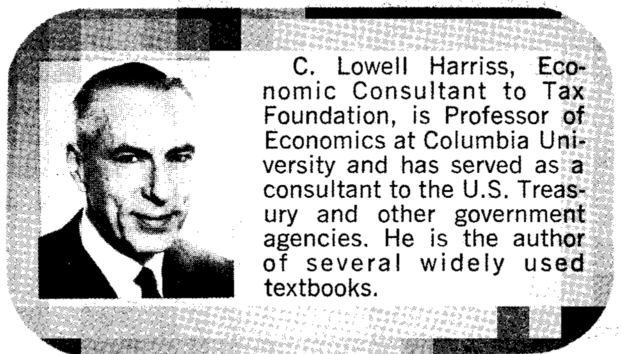

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Table 2
Property Tax, Average and as Percentage of Income, and Estimated Net Benefits of Government Spending over Taxes, 1968, Families and Unrelated Individals, by Income Class

Adjusted Money Income	Property Tax[a] Average Amount	Property Tax[a] As Percentage of Income	Net Benefits as a Percentage of Total Income[b]
Total United States	$464	3.7	+ 2.1[c]
Under $2,000	158	8.3	+183.9
$2,000- 4,000	222	5.3	+ 76.4
4,000- 6,000	277	4.3	+ 29.5
6,000- 8,000	334	3.8	+ 10.7
8,000-10,000	406	3.7	+ 4.1
10,000-15,000	557	3.8	− 1.2
15,000-25,000	875	3.8	− 5.7
25,000-50,000 }	1,563	2.5	− 11.6
50,000 and over }			− 27.1

a—All of tax on busines property and on rental housing is assumed to be passed on to customer (or occupant).
b—Taxes paid offset against the estimated benefits of government spending. The authors estimate on three bases of assumed distribution of "nonallocable" benefits—income, population, and wealth (capital). The estimates here allocate benefits on the basis of income. Each of the others, by capital and by population, shows the groups with under $4,000 of income as receiving considerably larger net benefits than shown here.
c—Overall net benefits exceed taxes because of spending from nontax revenues and borrowings. Negative amounts mean that taxes exceed benefits.
SOURCE: R. A. Herriot and H. P. Miller, "Tax Changes Among Income Groups—1962-68," Business Horizons, February 1972.

of land affects the price—the capital amount—which a buyer will pay. The higher the tax, the lower the price. The capital value will be (1) the expected net income related to (2) the yields which are obtainable from assets (of equal quality). For a piece of land, assume that for as far in the future as one can see the gross income, after all expenses except property tax, will be $1,200 a year. The tax will be $200. Investments of comparable quality are yielding 5% a year. Then the formula for determining the price as forces work out over the years is:

$$\text{Price} = \frac{\text{Gross income \$1,200 minus tax \$200} = \$1,000}{\text{yields of comparable properties, 5\%}}$$

$$= \frac{\$1,000}{5/100} = \$20,000$$

The price, $20,000, is the capital sum which will bring the net income expected from this property. If there were no tax, the price would be $24,000.

Now assume that the tax rises by $100 a year and that there is nothing which will raise the gross income, nothing to make the land more attractive to a buyer. Then

$$\text{Price} = \frac{\text{\$1,200 minus \$300 or \$900}}{5/100}$$

$$\text{Price} = \$18,000.$$

The rise will be capitalized into a $2,000 decline in capital value. The change in price may come quickly; or time may be required for buyers and sellers to take full account of the change in tax. The person buying afterward is no worse off because the tax is $300 a year instead of $200. He took the extra $100 a year into account when buying. Much as the prior owner might have wanted to charge a higher price after the tax went up, nothing enabled him to do so. Neither the $200 in the first case nor the $300 in the second would be a burden on a buyer as compared with what he would have to pay (land plus tax) if the tax at time of purchase had been lower.

Note, however: If the $100 is spent in ways that add to the to the attractions of the locality, then the gross income in some meaningful sense—*e.g.*, benefits of better schools—will go up. Conceivably, there may be no drop in the price of land. The new buyer might be willing to pay $20,000 because he would get more in public services.

The principles of supply and demand operate—except that the quantity of land is not changeable in the way that supplies of manufactured products can be raised or lowered. As to supply of land, the prior owner will presumably have tried to get as high a price as possible. He could not reduce the supply (space on the earth's surface) to get a higher price. As to demand for the piece of land—except as the spending of more tax revenue raises demand for living or conducting business in the area—nothing will offset the effect of higher tax in lowering the price.

Some of the present property tax on land is no real burden on the owner or user. If tax had been lower, he would have had to pay a higher price.

Any reduction of the tax on residential property would produce a one-time capital gain for the present owners of land, in amounts ranging from the trifling to perhaps several thousands of dollars. Purchasers or users later would get no continuing benefit. Persons buying the property would have to pay a higher price for land corresponding to the lower tax. Some houses, of course, are held for decades; each month, however, thousands are sold. The hundreds of thousands who buy new houses each year would have to pay higher prices for land. They would not benefit from the lower property tax on land. Over even a not-so-very-long run, the "tax relief" would lose much of its effect.

From one locality to another, perhaps one fifth to one third or so of the total tax on housing is attributable to land. For both homeowners and businesses some of the present tax will have been capitalized at the time of purchase. Having been allowed for in the purchase price, this tax does not make the present owner or user worse off than if the tax had been lower at the time of purchase. Assuming that nothing about a tax increase (as distinguished from spending the funds) will make the land more valuable, tax increases on land will not be shiftable. Businesses that may try to shift an increase in land tax to consumers will find nothing in conditions of market demand and supply which will make the product more attractive.

Since World War II, despite increases in *both* tax rates and interest rates, land prices have generally gone up. Nevertheless, the rise in prices does not disprove the principle of tax capitalization. For one thing, greater local government spending has played a part in raising the demand for land. So have other forces, notably increasing population and income, as well as general price inflation.

Is the property tax on man-made capital—home and factory buildings, machinery, equipment of public utilities, barns, business inventory—largely or only in small part shiftable to the consumer? How much tax probably remains upon the supplier of capital by keeping his *net, after-tax, return* lower than if tax were less? Our knowledge is incomplete.

Nevertheless, economic analysis suggests that significant amounts probably remain as a burden on capital. That is, despite all efforts possible to raise prices enough to make the consumer (and renter) bear the burden, the saver who provides the capital will get less net income after property tax than if it were lower. Market forces of supply and demand for capital do not permit a shifting of all of the tax forward to consumers.

One assumption which seems generally correct is that the amount of new saving does not depend greatly upon differences in interest rates, net after tax. Higher property taxes, then, may not reduce the country's total supply of new savings to permit appreciably higher pre-tax yields.

Moreover, for the savings that are made and seeking investment outlets, there are not many opportunities which are free in a fundamental sense from property tax. Virtually all productive facilities (including housing) are taxed. There are few places in this country for the flow of new savings to go where there will be no property tax (direct or indirect). We have little way of knowing what the yields before tax would be if the tax on man-made capital did not exist. But in much of the economy the yields would certainly not be lower by 1½ percentage points, a level which is almost the bottom of true effective rates over much of the country. Looking at the same conclusion from the opposite point of view, we can say that suppliers of capital are not in fact getting a gross return which is enough higher than in a "no property tax" world to mean that all of the burden is being shifted to the user of capital facilities.

The 1967 Census found, however, that effective tax rates in 13 out of 122 cities were 3% or higher (and now, 1972, probably significantly more) and from 2% to 3% in 40 more. In such cases some of the tax on man-made capital is more likely to be passed on to the user. Assume that the effective tax rate on new buildings or productive machinery in City A is 4½% of full value, while over broad areas the rate is around 2%. Capital for new housing and for buildings and machinery for business will not come to City A except when investors believe that the after-tax return will be as good as is obtainable in lower tax areas. Businesses expanding must have confidence in their ability to shift this part of the property tax to the consumer (including the buyer or renter of a house) or backward to owners of land. The economic processes are not clearly observable. But market forces of supply and demand for new capital will enable businesses to pass along a *portion* of the tax to consumers. The estimates in the tables assume that all of the business tax is shifted in this way, but a less extreme result seems more probable.

Whether the tax on residences falls on persons as consumers or as suppliers of capital probably makes no great difference as regards most homeowners.

For rental housing, however, some importance does attach to the decision as to the sharing of the tax between the occupant and the owner (and creditors) as suppliers of capital. Estimates such as those in the tables which assume that *all* is paid by the renter will attribute more of the total burden to lower income groups, and less to the higher, than if one assumes that the suppliers of capital for rental housing bear part of the property tax. They do so, of course, not out of generosity but because they have few investment opportunities free of the tax. Moreover, as regards shifting the tax on business property, the tables probably assign too much to lower income groups(more largely consumers) and too little to higher groups (relatively larger as suppliers of capital.)

The percentages in the "tails" of the income distribution—classes under $4,000 and over $25,000—would probably be enough different to change the impression significantly. Through the income ranges including most of public, however, the averages would likely seem little different.

Ownership of wealth is more concentrated than is the receipt of income.[1] Many persons with low incomes own little or no capital, either man-made or land. In relation to income, therefore, property tax as a burden on capital probably does have a progressive element. It will, however, be very uneven as among families with equal incomes.

Conclusions about what "ought" to be done about property taxation require the best evidence possible about the tax as it now exists. To the extent that decision will rest upon beliefs about "who really pays," more study is needed.

Clearly, burdens today differ very widely from one place to another. For the country as a whole, however, for the great majority of families the tax appears to be roughly proportional to income. At the lowest and the highest ranges of the income distribution the estimates in the tables reveal considerable regressivity relative to income.

Yet these statistical findings rest upon two assumptions which, though perhaps relatively unimportant for the vast middle income ranges, influence significantly the results in the "tails" of the income distribution, (1) that *all* of the tax on rental housing and business property is shifted to users, and (2) that *none* of today's tax was capitalized as a burden on past owners of property. More acceptable assumptions would be that a significant fraction of the burden on land is not shiftable to the renter or customer of business and that some of the present tax remains on the supplier of capital. To the extent that these assumptions are more correct than those used, the estimate of burdens at the lower income ranges would drop and those higher up would rise.

Whatever the true distribution, the *amount* of tax is sometimes "high" by any relevant standard. Certainly, the actual burdens are high enough to have signficant effects beyond raising revenue. A later issue of *Tax Review* will deal with such aspects.

1. A paper by Dr. Mason Gaffney, "The Property Tax Is a Progressive Tax," to appear in the National Tax Association *Proceedings . . . for* 1971, develops this point.