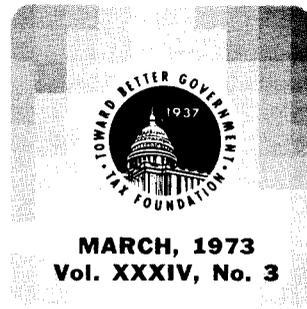


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## The Property Tax Under Fire

By Kenneth Back

As tax burdens have increased to meet skyrocketing local expenditures, the property tax has come under fire from a number of directions. One governor after another has called for measures to lighten the load of property taxes. The school finance decisions being handed down by both state and Federal courts are regarded by many as the most significant developments in many years because of their potential impact on public school finance systems, and, in the long run, on the property tax.

President Nixon in 1972 singled out the property tax "as one of the most oppressive and discriminatory of all taxes" and expressed concern about its burdens and school finance reform. By Presidential direction, the Advisory Commission on Intergovernmental Relation (ACIR) has conducted a major study of the property tax and of the feasibility of replacement taxes at the national level for partial school financing.

The property tax is an easy subject to oppose. While there are numerous critics against it, there are too few advocates willing to speak in its favor. A nation-wide opinion poll by the ACIR covering all different socio-economic backgrounds and areas of residence showed the property tax to be the most unpopular of all major revenue sources. Just why such attitudes were held was not asked. In my opinion, the reason why people feel as they apparently do toward the property tax or, for that matter, any tax is one of the most important criteria in an evaluation of a tax. Some reasons for the apparent unpopularity seem to me to be its burden on the low income and elderly, inequities of administration, and its visibility as a locally imposed and collected tax.

The battle cry to reduce burdens and eliminate inequities with deliberate speed and at all costs might imply that, at least in the minds of some, the load is no longer bearable, the inequities are not correctable, and the tax should be abolished. Yet, despite all the rhetoric this ancient tax has served local government well, and in my opinion, has great merit when compared with other ways of financing local government. On the basis of important criteria for judging a revenue source, the property tax can rank high. Its

productivity, local impact and control, direct citizen participation, linkage between taxes paid and benefits received that serves to hold down local expenditures, and its role in the defense against the forces of centralization are all desirable characteristics. Moreover, it is the only tax that can recapture for the community the property values that the community has created.

To be sure, it has defects and rough edges when viewed out of context of the overall tax-expenditure structure; as the tax burden increases, these are being highlighted. But few in possession of the facts would seriously recommend the consequences of its outright abolition—namely, the closing down of all units of local government and all public schools or finding a replacement capable of producing \$42 billion annually with a growth rate of 10 percent each year. Only a complete optimist with his head in the clouds can hope for major reduction in the property tax without development of new taxes or increases in others. To maintain even the current levels of local government service, which seem to be essential to a growing, affluent society, will require more revenue than is now being produced.

### **This Issue in Brief**

The property tax will survive current criticism, Mr. Back predicts. But he says major changes will have to be made in its structure, administration and the uses to which its revenues are put.

Legislators, long reluctant to make the reforms, will now be moved to act, not so much by the current outcry against property taxes, as by court decisions on school financing.

He says only a complete optimist can hope for major reduction in the tax which raises \$42 billion a year and grows 10 percent annually, without new taxes or increases in other taxes. He presents the arguments for retaining the property tax.

Broadly speaking, all taxes are levied against the basic components of income, expenditures, or wealth, or some combination. None of the components should be neglected at the expense of the others. For example, if income and expenditures alone were taxed, growth of much non-income producing wealth would escape taxation. The property tax serves to reach the type of unrealized "income" which results from property appreciation and speculation. Moreover, a tax on real property tends to encourage more efficient use of property. To have any semblance of an equitable tax system, property which represents a major portion of wealth must be considered a proper subject for taxation.

With the Federal government relying predominantly on income taxes, and the states on consumption taxes, local government's use of a well designed and properly administered property tax has considerable logic. Since the introduction of sales and income taxes, the property tax has declined as a portion of all taxes collected by state-local governments. But this is small solace to those home owners whose burdens have been shooting up. Despite the fact that the property tax may be over-worked in some areas, as long as local government survives and public service requirements are relegated to the local level, that government must have a reliable fiscal base unless it is to become a mere pawn of the state or Federal governments.

The protection of the individual's rights to possess and use property was and is, after all, a major incentive for the organization of local government. There is a compelling logic, I think, in the idea that costs of maintaining the government that has the property rights protection function should be covered on some basis *pro rata* to the values of the separate property rights being protected. It is logical to consign the property service and protection functions to the bottom level of government, and it would be completely reasonable to finance the costs of fulfilling those functions by levying charges against those properties.

This rationale is, of course, strained when one tries to justify all of the present and past uses of the revenues produced by the property tax. While public health, welfare, and education are related only remotely to the maintenance of property rights, they are still considered partly or wholly local functions. The argument that public education should not be financed by a strictly local property tax should be simplified to a contention that public education should not be financed by *any* strictly local tax. The quality of education should not be limited by inadequate and unequal local sales or

income any more than by inadequate and unequal property values. Recent court decisions have put the property tax indirectly under fire as a sort of phantom culprit in the school financing issue. The real issue, however, relates to the variation of expenditures resulting from the accidental unevenness in the distribution of wealth and has nothing to do with the merits of the property tax itself.

Many local officials fear that the concept of local home rule will be seriously violated if any of the functions being performed at the local level are transferred to or financed by a higher level of government. Before jumping to this conclusion, there is a need to more clearly define just what are the most desirable and feasible areas of local government responsibility. This will not be an easy task because of the many vested interests in the *status quo* of both local government and the property tax and of the belief that where the power rests is where the money comes from. Residents of districts which contain large amounts of wealth, zealous local officials, and taxpayers who are enjoying relatively low tax burdens will resist to the bitter end.

### **Local Control Needed To Maintain Autonomy**

Yet, change is inevitable in local government and in the way certain services will be financed. But this is not to imply that the local property tax will vanish from sight—nor should it, since it is the one tax that is best suited for the support of local governments. Maintenance of at least some local control over the tax—such as rate-setting authority to cover financing of non-school expenditures—is vital if voters are to retain some local autonomy. In an age when the centers of power grow increasingly remote from the people they serve, it is hard to believe that many citizens will want to trade their remaining autonomy for the sake of property tax relief. Voters in four states during the 1972 election overwhelmingly defeated proposals to abolish or restrict the use of the property tax and substitute other revenue sources.

Above the outcry for reduced burdens, one must ask just what is otherwise wrong with the property tax? Are there flaws which cannot be corrected? Many economists condemn the tax on any number of theoretical grounds; and there are those who say that as it exists in practice, the property tax can be justly criticized on almost every criterion relevant to judging a tax, such as: elasticity, growth, ability to pay, regressiveness, benefits received, equity, administration, and so forth. In fact, if all the charges of all the critics are accepted, the local property tax is a major cause of many of the problems of the nation: urban slums, the struggle of fixed-income families, the financial woes of the cities, and the shortcomings of public education. I just do not believe it. I have yet to see a completely convincing case made on any of these criticisms even though several have some validity.

We hear most about regressiveness. Generally speaking, those with lower personal incomes apparently do pay a larger percentage of their incomes in property taxes, but this is also true of other major taxes. The sales tax in most states is also regressive. Even income taxes can be selectively regressive in that loopholes enable some middle and high income individuals to pay



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less tax as a percent of their income than do some persons with lower incomes.

A point often overlooked is that expenditures financed by property taxes most often tend to be distributed progressively. Lower income families usually derive relatively greater benefits from the spending of the tax funds than do upper income families. Studies have shown that for the lowest income groups, expenditure benefits financed by the tax tend to be one and a half to two times greater than the tax burdens.

Another criticism is that the property tax cannot be justified on the basis of benefits received. Critics who rate the tax low on this score defy comprehension. The value of property is certainly influenced by the availability of police and fire protection, sanitation, street cleaning services, and a host of other services performed by the local government. For homeowners with children, what would their home be worth without good neighborhood schools? Widespread experience suggests that most taxpayers do not mind paying fair property taxes when local services, especially schools, are first-rate.

Business often objects to property taxes on several grounds:

... Since ultimately all taxes are passed on to individuals, the most equitable tax applies directly to people rather than to business.

... Local property tax revenues are used to finance numerous "social" services which benefit businesses only indirectly if at all.

... There are instances where it is politically popular to tax business as heavily as possible in order to keep the tax burden low on the resident homeowner.

... Unequal tax burdens among competing communities affect competitive pricing positions.

On balance, business may have some grounds for concern over its competitive pricing position. From the point of view of local government, however, businesses do demand and receive local public services. What's more, many businesses impose special costs on local jurisdictions which can more than offset amounts paid by them in local taxes. A tax on multijurisdictional businesses enables a locality to export a portion of the tax by passing it on in prices to customers in other localities. Finally, to the extent that property taxes are not fully passed on in the form of higher prices, the tax on business is a means of deriving some revenue from nonresident property owners and shareholders who may not pay any other taxes to the jurisdiction.

To the extent that property tax burdens are excessively heavy or regressive in the low income range, this result need not continue. Corrective measures have been successfully tested. Several states, using the tax credit method (circuit breaker), permit the low income elderly and other select groups to claim a credit against their state income taxes or to receive an outright refund if no income tax is due, for all or a portion of local property taxes paid. Most of these relief programs have been financed and administered by the states.

Efforts to eliminate inequities have been a major impetus in the broader movement to improve administration. Some equity problems resulting in large part from poor administration are:

... Inequities of assessments in relation to market value and particularly as to low vs. high value properties.

... Discriminatory assessments as between classes of property.

... Gross undervaluations of land as opposed to improvements in most jurisdictions.

Some assessment officials classify properties for assessment purpose when the laws call for uniformity, and they seem to do so with, at least, the passive consent of the electorate. This practice does not seem to benefit any one group, but rather appears to favor some taxpayers over the whole range of categories. Owners of commercial, industrial and public utility properties have asserted, for years, that homeowner-voters have been deliberately underassessed. Now comes the "tax protest" groups to declare that the big influential guy is given the break and that small property owners are being overassessed. Regardless of who is right, for every property that has been misassessed intentionally, there are thousands that have been misassessed unintentionally.

### **Better Administration Called Key to Problems**

What do we really mean by good property tax administration? How do we get it? Today's assessor is confronted, on the one hand, with a rapidly changing real estate market and a wide range of property types and, on the other hand, with taxpayer demands for equalization which grow more intense with each increase in tax rates. As burdens have gone up, the taxpayer and the courts have demanded more equitable assessments. There are no easy solutions. But the primary key is administration that treats all taxpayers fairly and without discrimination. The following areas hold the most promise.

1. A modern property tax law that lends itself to good administration;
2. Assessment districts large enough to support a professional and well organized staff;
3. Competent assessment personnel with adequate pay and tenure of office;
4. Financial support adequate for the task to be performed;
5. Greater state involvement and assistance;
6. More effective use of electronic computers in the assessment process;
7. Simplified and improved appeal procedures.

Technically, there are no insurmountable barriers, but from a political point of view providing a workable system and adequate financing is no small undertaking. A good assessment product is not feasible when districts are too small to support a full-time assessing staff. Yet the political drag is such that a crisis of the first order seems necessary to bring about a change. For too long we have assumed that in the interest of local home rule property assessing must always be performed by the subdivision it finances.

Substantial improvement would not require huge sums of money. Despite what some critics say, the property tax is relatively easy to administer. The principal cost relates to the valuation function, which does

require highly skilled professional assessors. Unlike income and sales taxes, however, the real property tax does not require complex accounting, processing of returns, auditing of books and records, costly taxpayer education, and tax delinquent programs. The fact that delinquent taxpayers can forfeit their property in the tax sale process make tax collection virtually self-enforcing and precludes the need for criminal prosecution for tax evasion.

Most of the ills of the property tax are correctible. The inequities can be largely eliminated; inordinate burdens can be reduced. But traditionally, needed change has been slow. Legislators have long been reluctant to face up to reforms to make the property tax a viable fiscal instrument tuned to changes in the economy. The political pitfalls are considerable. Short of an outright revolution in public attitudes, legislators will usually not act on tax matters unless provided with a political heat shield such as a court mandate.

While the public outcry may have won the most headlines, the greater force for change is coming from recent court decisions on school financing. Legislators are now confronted with the fact that major changes are inevitable. While there is much speculation about how property taxes must be levied for school purposes, nothing less than state-wide action seems likely to meet the requirements laid down by the judiciary. Although the Supreme Court has yet to act, there is a little doubt that the court decisions will hurry property tax history along.

As the states face up to court-ordered responsibilities it is to be hoped that they will also provide for more equity and a workable system for efficient administration. A coat of veneer over the bad features of the present system will not improve the most important element—the determination of the original assessment. If the assessor does not establish a correct original assessment, then determinations with respect to who pays the tax, its burden, who needs relief, and what the existing effective rates are, cannot be made accurately.

It now seems reasonable to expect more Federal involvement than has been the case heretofore. What this will entail, however, is not clear. It is difficult to comprehend a Federal program of reducing property taxes that would not create as many problems as it solves.

First, direct and significant Federal participation in property taxation requires a rethinking of traditional concepts of federalism; namely, that property tax issues are the exclusive concern of state and local governments. Federal action could result in more concentration of power in Washington for decision-making on state and local revenue and expenditure programs.

Secondly, substantial tax reduction for every homeowner cannot, in my opinion, be justified. A majority of taxpayers may not in fact need relief; certainly property tax burdens vary considerably within each state, among the states, and from region to region. A seven-to-one range in per capita property tax collections between the lowest and the highest state is indicated in 1970 data. Furthermore, an eight-to-one spread in the burden between the lowest and the highest state is indicated when property tax burdens are related to income. Thus, a national general property tax reduction

would be difficult to tailor to the needs of each local jurisdiction. While such a program would provide relief where burdens are high, it would also give relief where burdens are not now excessive. Moreover, some jurisdictions with relatively high property tax burdens would be rewarded (through tax relief funds) for their unwillingness to use income, sales and other non-property tax revenue sufficiently if at all.

Thirdly, substantial and general property tax reductions by any level of government would result in a number of effects—some of which may not be desirable. In addition to reduced property tax burdens for those who may not need such reductions, a permanent increase in income would occur to landowners. And owners of houses and other improvements would receive temporary income increases. Moreover, major reductions in property taxes would affect the distribution of wealth through the impact on capital gains and would also reduce incentives for landowners to use their land in the most efficient manner. Land could be held for appreciation and speculative purposes at a lower annual cost.

There are, however, some areas where the Federal government might make a constructive contribution by use of the Federal financial carrot. First, it could provide funds to those states which grant property tax relief to their low income and elderly, thereby encouraging states to alleviate excessive burdens. Such Federal aid could be justified on the basis that state and local taxes should not thwart existing Federal programs for providing a subsistence income floor to the elderly and to low income families generally.

Secondly, the Federal government now has programs to provide specific types of training. Financial aid in assessor training could contribute greatly. A Federal Institute for Assessors, or Federal funds for universities in each state to establish state assessor institutes, could provide the needed catalyst to improvements in assessment.

Thirdly, more research, statistical development and analysis, and improved assessment-sales ratio studies are sorely needed. Federal funds could provide a substantial boost.

In addition to channeling Federal funds to local governments, the Federal government could begin to assume greater financial responsibility for many of the expensive social programs which presently overburden local governments. At present, the lion's share of total U.S. tax collections accrues to the Federal government, while the major responsibility for supplying non-defense public services is at the local level. If this imbalance were rectified by shifting most of the heavy costs of welfare and education to higher levels of government, local government might very well be able to finance the rest of its more traditional functions with reasonable property tax burdens.

The property tax will survive and prosper. This is not to imply that all is well. The changes needed are major ones which, taken together represent a monumental task for legislators, administrators, and taxpayers for years to come. Energies must be allocated to restructuring the tax and to improving its administration in order that it may continue to play a significant, perhaps even greater role, in state-local financing.