

Texas Commission on Public School Finance

Justice Scott Brister, Chairman

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Turning Points: Modern Property Tax Property Developments in Texas

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Property tax is the largest tax imposed in Texas. Texas' local governments are heavily dependent upon property tax revenue and impose some of the highest and most broadly based property taxes in the country. Battles over how to deal with this problem have been almost continual. Over the past several decades, there have been at least four identifiable turning points in the development of the property tax in Texas. Not all have been successful. None have been characterized by a love of property taxation.

The "Peveto Bill"

For roughly a century and a half, property taxes, including both state and local levies, were the largest sources of revenue in Texas. Despite this heavy reliance, administration was haphazard and not carried out by trained professionals. Delinquencies were common, taxes went unpaid and uncollected, each property received a separate and often conflicting appraisal from every taxing unit, and even where the tax was methodically imposed and collected, appraisals bore little resemblance to market value. Uniformity was nowhere to be found, even within the administration of a (now repealed) state property tax. Texas had a wild west tax system sorely in need of repair.

In 1979, a bill authored by Rep. Wayne Peveto of Orange established the first turning point in the modern Texas property tax system, creating Central Appraisal Districts staffed with professional appraisers, appraisal at market value, and the end of assessment ratios which had long obfuscated the distinction between the appraisal process and the actual imposition of tax levies. The Peveto bill is generally considered to have brought about major improvements in property tax administration and remains the foundation for today's system. Property owners who pay taxes in multiple states tend to agree that the Texas system is superior to those of most states, though it is also agreed that Texas' high tax rates remain a problem.

Governor Bush's Undertaking and Aftermath

Following the 1995 legislative session, Governor Bush established a Staff Work Group on Property Tax Relief to study the problem of rising property tax burdens, which published a report on options for increasing state revenues for the purpose of buying down the property tax imposed by Texas school districts. The governor subsequently issued executive order GWB 96-4 creating the Citizens Committee on Property Tax Relief, which took public testimony around the state on the options identified by the Staff Work Group.

This was a turning point in that the identification of the property tax problem did not stem from a perceived lack of uniformity, efficiency, professionalism, or administration. Rather, it grew from the simple recognition that the property tax was too high and relied too heavily on assets that constituted an ever-smaller share of a modern, service economy. There was no way for Texas to administer or reorganize its way out of this kind of problem. The tax system itself needed reform, and the property tax levied by school districts – which accounted for roughly half of all property tax levies – could be bought down using state revenue raised from other taxes.

Because the system of funding public education is shared between local school districts and the state, reducing the school property tax is more practical than reducing the property taxes imposed by other local governments, which share no similar fiscal system with the state.

The plan that was ultimately introduced in 1997 was based largely on a redesigned franchise tax,¹ the increased proceeds of which would be used to purchase across-the-board school property tax rate reductions. After a contentious legislative session, in which a T-shirt commemorated the endeavor as “The Tax Bill That Would Not Die”, the bill, in fact, died.² And while Governor Bush would not propose it, or anything like it, again, his 1997 plan set the general pattern for all the major relief efforts that would follow.

Upon Governor Perry’s succession and later election to the Governor’s Office, and throughout much of his lengthy tenure, proposals to buy down the school property tax were brought regularly to each Legislature, were bitterly contested, and met the same fate as did the Bush plan. In addition to regular legislative sessions, there were three special sessions called for the purpose of property tax relief. Also during this period, in 1999, the first across-the-board school tax buy-down was enacted in SB 4 by Teel Bivins of Amarillo. Does anyone remember their five-cent tax reduction? Well, the state paid for one. And is still paying for it, at least theoretically.

During these years, every imaginable combination of state funding options, from sales taxes on services, to broad-based business income taxation, to variants of value-added taxation, payroll taxation, elimination of sales tax exemptions, gross receipts taxation, and even a proposed “basket tax”³ were proposed and tested in the legislative process, where each, in its turn, went down in flames. There was general consensus on how to accomplish property tax relief – buying down the school tax rate – but there was no consensus on how, or even whether, to raise new money to pay for it.

Texas Tax Reform Commission

On November 21, 2005, Governor Perry issued executive order RP 52 creating the Texas Tax Reform Commission (TTRC) to make recommendations for “the goals of lowering property taxes, ensuring greater tax fairness, and providing a long-term, reliable source of funding for public schools.”⁴ As with Governor Bush’s team of a decade prior, the TTRC would be charged with developing recommendations for financing property tax relief.

What was different was that on November 22, 2005, the Texas Supreme Court ruled the state’s school finance system unconstitutional and gave the state six months to enact a solution. The solution would have to provide “meaningful discretion” to school districts in setting their taxes, because the Court found that the state was effectively setting both a floor on the tax, through its

¹ The proposed redesign of the franchise tax was a form of business value-added tax. The Bush plan also raised revenue from a small increase in the state sales tax, and in addition to property tax rate relief, would have increased the homestead exemption and created a new exemption for business inventories.

² While the other components of the Bush plan failed to pass, the state-mandated school homestead exemption was raised to \$15,000 from \$5,000.

³ The term “basket tax” was based on a shopping concept in which the buyer/taxpayer could choose which tax(es) to pay in order to generate the amount of state revenue needed to finance property tax relief.

⁴ http://govinfo.library.unt.edu/ttrc/press_releases/2005_11_21-1.html

requirements on the districts, and a ceiling on the tax, through a hard cap of \$1.50 per \$100 on the M&O tax rate. The Court determined that setting both the floor and the ceiling constituted a *de facto* state property tax, prohibited by the constitution. Governor Perry called a special session for April 17, 2006 to address the issue. The restoration of meaningful discretion to school districts in setting their tax levies was the one must-pass attribute of any plan to be considered during the special session of 2006.

The plan proposed by TTRC⁵ passed largely intact and in time to meet the Court's deadline. The means of pushing down the tax rate was a "state compression percentage" of 66.7% that lowered school M&O tax rates by one-third. The means of holding down the school tax rate was a requirement that any increase in the M&O tax of a district above the rate of \$1.04 be ratified by the voters of the district. These two limiters remain in effect, but over time, forces including rising property values, bond elections, and M&O tax rate increases by school districts (even those requiring voter approval) as well as by cities, counties, and special-purpose districts have combined to make the 2006 relief difficult for most Texans to see or feel. The last official estimate of the cost to the state budget for keeping the rate compression in effect was \$7 billion a year.

Over an extended period of rising property values, a static state compression percentage becomes less and less effective as the state's share of financing the public school program declines. Exactly the opposite will occur if Texas undergoes an extended period of falling property values. Decreasing the compression percentage over time to keep taxes down over the long run, whether accomplished by an automatic annual formula or by periodic acts of the legislature, would be required, at significant cost to the state, to prevent rising values from automatically resulting in higher school tax bills. The current combination of the static compression percentage and rising values has created more fiscal freedom for the state in its budgeting than would otherwise be the case. No magic formula has yet been devised that, in a period of rising property values, can keep the school tax down without requiring either regular increases in other state revenues or further restrictions on spending on other state budget needs.

As to whether the mechanism has delivered long-term tax relief depends on whether one defines relief as the difference in tax between the past and the present, or the difference between the present and what would-have-been-the-present. In the former case, simply comparing tax levies over time, one would have to conclude that no, Texans did not receive long-term relief. But in acknowledging how high taxes *would have been* without the change – say, if school tax rates were still at \$1.50 – then property taxpayers clearly are benefiting even today from the rate compression. There are still over 500 school districts – nearly half – imposing M&O tax rates of \$1.04 or less. Analytically, the proper evaluation is "what is" versus what otherwise would be. But if the citizens don't see or feel what a law change has done for them, one might question whether it can be counted a long-term success.

The plan that had been developed by the TTRC and passed by the Legislature left non-school taxes unchanged. Since the 2006 session, perhaps the largest property tax relief measure to

⁵ The funding mechanisms were a redesign of the franchise tax based on "margin", an increase in the cigarette tax, an administrative change in the motor vehicle sales tax, and several billion dollars in general revenue.

become law was the 2015 increase in the state-mandated school homestead exemption to \$25,000 from \$15,000.

Today

It has been 12 years since Governor Perry called the special session that reduced school M&O tax rates. Today's turning point reflects a recognition that the school tax is not the only source of the property tax problem. With the apparent success of the 2006 law in keeping school tax rates in check for a decade via the mandatory voter ratification requirement, legislators have proposed that a somewhat similar (albeit less restrictive) requirement be placed on taxes imposed by non-school taxing units—cities, counties, and special-purpose districts such as junior college districts and hospital districts. Interests representing these taxing units have opposed such a change on the basis of local control, and also in pointing out that the state continues to benefit financially from rising property values, implying that the property tax problem is really a state government problem. State lawmakers fire back that the tax levies of the non-school taxing units have been rising faster than those of school districts and that voters should have the right to approve or disapprove of tax increases above a certain rollback⁶ level.

To date, no law has been enacted to require an automatic rollback or ratification election for non-school taxing units, though interest in doing so remains. Both chambers of the Texas Legislature passed bills in the 2017 special session that would require such voter approval, though differences between the two bills were not reconciled. More recently, Governor Abbott has proposed that local property tax levy increases be capped at 2.5% per year, and that a “revenue cap and lower rollback rate could work in concert to strenuously protect against property tax increases”.

In conclusion, property tax is a large and unpopular means of paying for local government in Texas, and interest in moderating its growth, or even repealing and replacing it, is ongoing. Since 1995, the state has purchased two across-the-board rate reductions in the school tax, quintupled the size of the homestead exemption, and still tax levies and dissatisfaction are rising. History would suggest that periodic successes are feasible, but that a lasting solution that is satisfactory to all may be hard to come up with.

⁶ Current law allows non-school taxing units to increase their taxes by 8% per year without voter approval. Revenue collected from new properties is also allowed without voter approval. Any proposed property tax rate that exceeds the rollback rate subjects a taxing unit to the possibility of a rollback petition from its electorate. If sufficient signatures are obtained on a petition in 90 days, an election to roll the tax increase back to the rollback rate is held. Successful petitions are rare in major metro areas due in part to the large number of signatures required.