

Fairness and Property Taxes in Texas

Steven M. Sheffrin
Professor of Economics
Affiliated Professor of Law
Executive Director Murphy Institute
Tulane University

Property Taxes are Never Popular

- Of all the state and local taxes, property taxes are among the least popular—less popular than sales taxes.
- Despite their unpopularity, they do have many virtues
 - Stable, reliable source of local revenue
 - Generally thought more progressive than sales taxes
 - Local control
- In the absence of a personal income tax, property taxes have to do heavy lifting in Texas
- **How can we make them seem more fair?**

Why do they seem unfair?

- Tax on wealth not directly related to income
 - Ability to translate increases in value into current in-hand resources are limited.
- Taxes can increase on property without any affirmative actions by household or business.
 - Many of the changes are opaque and are the product of market forces as well as political decisions.
- Total levies are the sum of many units of government.
 - Virtually impossible to understand budgets and resources of multiple, complex local governing units.

Fairness in property taxation

- Based on extensive research, fairness in property taxation comprises:
 - Procedural fairness
 - Taxpayers treated with respect
 - Voice and ability of taxpayers to be heard
 - Predictability and stability of assessments
 - Some broad sense of vertical equity
 - Clear relationship between taxation and services provided.

The Texas Conundrum

- Without a personal income tax, the property tax finances schools in addition to all other local municipal units.
 - Property taxes are high by national standards. High effective tax rate (1.7%) and high national rank (13)
 - Reaches some types of property that other states exempt—e.g. inventory.
- From an external perspective, Texas has a rather comprehensive sales tax and high rates (over 8%)
 - Louisiana held it up as a model to aspire to for services.
- Margin tax brings in little revenue and is unpopular
 - State corporate taxes not major state revenue sources.

Any local revenue fixes? (I)

For non-school finance

- Exactions for New Construction
 - With property tax limitations, municipal governments in California and Florida made increasing use of exactions for new residential and commercial property
 - Developer pays and assessed on home price
- Charges and User Fees
 - Compared to U.S. average, user charges as percent of local revenue in Texas is slightly less (17.6% vs 17.0%)
 - Other states, like Florida, are more aggressive (24.6%)
 - Half of the difference is hospitals, but airports and solid waste also show differences

Any local revenue fixes? (II)

For school finance

- Other states facing hard property tax limitations used **Parcel taxes** (California)
 - Non ad-valorem fixed charge per household/business
 - Required voter approval (could run for 3 years)
 - Used for libraries and enrichment classes etc. Also could be used for non-school purposes.

Questions

- Could it be authorized in Texas?
- How would it fit in with existing court decisions?
- Review economic development incentives
 - Development professionals vs skeptical economists

Two types of property tax systems

- Revenue-based system
 - Political body decides on spending levels. Given assessed values, tax rates are then determined
- Rate-based system
 - Rates are fixed. Changes in revenue depend on changes in assessed value.
- Texas system a mixture of both
 - For schools, leans more towards a rate-based system for local contributions under current funding system.
 - For non-schools, leans a bit more toward revenue-based

Major Features of Texas System

- Market value assessment with frequent reassessment
- Done professionally by Central Appraisal Districts with appeal opportunities.
- No classification of property (no differential rates for homeowner, business, public utilities)
- Taxes on personal property and inventory
- Assessment limit increase of 10% per year for homeowners
- Homeowner exemption of \$25,000 against school taxes
- Special provisions for elderly (exemption and freezes)
- Some opportunities for tax rollback elections, different for school, non-school property taxes.

Buffering property tax shocks

MY DISCUSSION TODAY

- Limits on overall rates (e.g. California Prop 13) or
- Limits on revenue growth (levy limits)
- Classified property tax systems
- Assessment increase limits
- Opportunities for voter override of tax increases

OTHER ISSUES

- Circuit breakers and deferral programs
- Review commercial assessment practices
- Tax exemption review
- Payment options

Prop 13: Extreme Limits

- Brought relief and protection, but.....
- Hard rate cap of 1% on any property
 - Meant state had to supply additional funds to schools and local government
 - State passed laws on how to divide up property tax revenue within counties initially and over time
 - Took away local control, no overrides for ad valorem taxes. Became a state tax.
- Limit of 2% assessment increase per year
 - Increase limit so low, created visible inequities. Would have been mitigated by higher limit.
 - Created residential/commercial inequities

What options for Texas (I)?

- Strict cap on either tax rate or revenue increases?
 - PRO
 - Would provide relief and certainty for taxpayers
 - CON
 - For schools, no obvious substitute state revenue source to backfill reduced revenue collection and meet required educational spending levels.
 - For non-schools, also limits on revenue raising capacity.
 - Sales tax cannot be pushed too high—but that is a political decision for the state as a whole.

What Options for Texas (II)?

- Increased Homeowner Exemptions?
 - PRO
 - Can provide targeted relief for some homeowners.
 - CON
 - Shift burden to other classes of property OR generate revenue losses (substitute?)
 - Provides relief to high wealth homeowners
 - Does not prevent future increases
 - Does not protect small business

What options for Texas (III)?

- **Classification of property**

Assess at specified fraction of market value for different classes of property. 35 other states do this in some form, practices vary greatly (some have state formulas, some allow county discretion)

- **Questions**

- How much burden to shift and to whom? What classes? Homeowners, residential? Commercial/industrial? Public utilities? What to do with personal property?
- How would rates or rate limits have to change? (Might vary by county)
- Legal status—recent Texas S. Ct. case gives authority?
- Inventory already taxed

What options for Texas (IV)?

- **Lower assessment limit increases** for homeowners from 10% to say, 7%
 - With same revenue target, this just redistributes the tax burden.
 - Could be a constraint on local officials, as they would need to raise rates for same revenue (pros and cons).
 - For schools, however, this could require temporary additional state funds under current system.
 - **PRO**
 - Provides a cushion for homeowners. Current limit is high for states with limits.
 - **CON**
 - If revenue collection remains unchanged, just shifts burden to those whose property has appreciated less.

What options for Texas (V)?

Enhance Rollback Process

- An important rationale for property taxation:
 - Local tax and reflects wishes of voters/taxpayers.
 - This means voice or ability to express views is important for maintaining long run support.
 - This suggests voters should have enhanced say.
- Political actors may have different agendas.
 - Current 8% non-school limit with required petition tilts the playing field in favor of officials—limits their incentive to find other revenue sources.

Rollback Options

- **Options for Non-Schools**

- Lower rollback rate (or change calculation method)
- Lower or eliminate petition threshold
- Enact one or both of these, but require say, 55-60% to override (giving local officials benefit of doubt)

- **PRO**

- Enhanced rollback promotes democratic assent
- Provides a safety valve for future of property tax.

- **CON**

- Could be captured by anti-tax factions
- Creates uncertainty for municipal planning

What about for schools?

- **Any substantive changes would need to navigate complex legal decisions on school finance.**
 - Existing measures designed to insure equal tax effort (in terms of rates) for basic funding plus guaranteed yield per additional effort for some supplemental funding.
 - Recapture provisions are used to redistribute school aid to lower property wealth districts. So allowing lowering of rates would cost revenue for system.
- Automatic tax ratification election for rates over 1.04.
- **Given these considerations, not obvious how TREs for schools could be changed.**

Final Thoughts

- Texas property tax system has many admirable features.
- Don't want to destroy those.
- But given heavy burden, some additional consideration can be given to:
 - Alternative local revenue sources and thinking more about fees and exactions.
 - Additional safety valves for property tax revenue increases themselves.
 - Interaction with complex school finance system would require careful consideration of any mitigation methods.