

Background Paper 79-1

PROPERTY TAX RELIEF

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Introduction

For at least the past decade, demands to reform the property tax have increased in strength and volume. There are several reasons for this increase. First, the nation has experienced inflation in that period resulting in a virtual doubling of the Consumer Price Index. This inflation has raised the value of most property as well. In fact, property, especially residential property, has increased in value far faster than the rate of inflation in many areas. This has certainly been the case in the urbanized parts of Nevada. Second, the demands for government services have continued to increase. This, again, is especially true in rapidly growing areas such as Nevada. Third, assessment standards and assessment practices have become more uniform and more strictly enforced by states. Again, this has been true in Nevada also.

This combination of factors has resulted in property taxes increasing at rates greater than general inflation and greater than the growth in income for the average taxpayer. The property owner is "benefiting" from increases in property value but unless he sells the property, that "benefit" is really only a growing tax burden.

Two events explain the very great concern about property taxes in Nevada this year. First, statewide, assessed valuations have increased 19 percent over last year. This is far in excess of the general inflation rate and neither is it accounted for by new building. Second, the so-called Jarvis-Gann initiative in California has received a great deal of publicity in Nevada. The ease with which signatures were collected and the polled attitude of Californians on the initiative have demonstrated the depth and breadth of concern about property taxes in California. While the level of

property taxation nowhere in Nevada is as high as in most California urban areas, the California example combined with the trend in Nevada has caused alarm among taxpayers and among elected officials at all levels.

The Property Tax in Nevada

There are both constitutional and statutory provisions in Nevada that determine how property is assessed, the assessment ratio, the tax rate and tax exemptions.

There are several constitutional requirements for the property tax. First, article 10 requires that all classes of property be assessed on an equal basis. In 1974, an amendment was passed allowing for the assessment of agricultural land based on its use rather than on its actual full value. The constitution also allows the exemption from taxation of property used for "municipal, educational, literary, scientific or other charitable purposes." In 1936, the constitution was amended to set a maximum rate of taxation of \$5 per \$100 of assessed valuation.

The statutes set the assessment ratio in Nevada at 35 percent of full value. This ratio was established in 1963. Nationwide, tax rates and assessment ratios vary considerably and make accurate comparisons difficult. Accurate comparisons are possible only by converting any tax to an "effective tax rate" which is the tax per \$100 of actual value. In Nevada, for instance, the effective tax rate on a \$60,000 home would be figured as follows:

Actual current value	\$60,000
Assessment (at 35 percent)	\$21,000
Tax rate, \$5 per \$100	
Tax Paid at \$5 rate	\$ 1,050
Effective Tax Rate	
(Tax as percent of actual value)	1.75 percent

The Nevada department of taxation has the authority to insure uniform assessments statewide. Further, the statutes set forth assessment criteria for all county assessors.

Alternatives for Tax Relief

Any taxes can be open to attack on two grounds. First, a tax may take in more money than is required to provide needed government services. Second, a tax may take more from some taxpayers than from others and this differential may be viewed as unfair. From the two grounds of attack come the two basic solutions to complaints about taxes. The solutions are reduction or redistribution. Obviously, these solutions can be combined although redistribution usually means someone will pay more.

Both of the basic aspects of tax relief seem to be present in Nevada at this time. In the first place, assessments, and therefore property tax revenues, seem to be rising faster than inflation and new growth combined. Constant tax rates will result in increased tax revenues in proportion to the increase in assessed value. The basic question here is if the additional income that would come from constant tax rates applied to new assessments is in excess of the legitimate revenue needs of local government. Since the state levies an ad valorem tax statewide, there is also a question of whether that revenue is in excess of legitimate state revenue needs as well. If so, some sort of tax rate reduction would seem to be in order.

The second question about tax relief is whether or not the tax burden is distributed equitably. There are no absolute, correct answers to this question. There are two guidelines that are used to measure tax relief equity. One is horizontal equity; that is, are people in similar circumstances treated similarly? The other is vertical equity; that is, does the system allow those in greater need to receive greater relief? These questions should be kept in mind as the alternatives for tax relief are reviewed. The property tax in general has been described as regressive. That is, rates are uniform regardless of property value. Actually,

studies on this subject conflict. With the exception of some low-income families, the property tax is not regressive. In fact, considering that schools get the biggest share of this tax, it is actually very progressive in that the highest value property usually has the lowest impact on services. This analysis of progressivity does assume that services received, not just ability to pay, is also a legitimate factor in determining progressivity. Be that as it may, it is clear that there are those whose taxes are increasing at a rate in excess of their ability to pay them.

Consideration of the following alternatives must include an examination of both the requirement to reduce taxes and the necessity to redistribute them. After each alternative, the basic pros and cons are presented. Also, each alternative will be denoted as basically a tax reduction or a tax redistribution device.

1. Homestead Exemptions: The concept is one of protecting from property taxation a certain amount of the value of the property which one uses as a residence. In Florida, this exemption is \$5,000. When an owner reaches age 65, the exemption doubles. It is double for the disabled too. Ten years ago, that was significant but since Florida assesses at full value, it is not a major tax saving today. It would be in Nevada however. For instance, a \$60,000 home is assessed at \$21,000 in Nevada. A \$5,000 homestead exemption would reduce the assessment to \$16,000, thereby reducing the tax on that house by 24 percent. Nationally, homestead exemptions range from \$1,000 in Indiana to \$20,000 in Hawaii!

Pro: The homestead exemption is simple to administer. It would provide across-the-board relief. Generally it offers proportionately greater relief to lower income homeowners.

Con: This exemption is not sensitive to need. It will provide no help to renters. The tax is not shifted, therefore the revenues lost must be replaced from other sources.

In Nevada, a constitutional amendment would be required to enact a homestead exemption.

The homestead exemption is basically a tax reduction technique and some other tax source would have to make up the difference.

2. Property Tax Liens/Deferred Taxes: One of the most difficult situations caused by rapid increases in property taxes is the hardship on the elderly on fixed incomes. Even though they have paid for their home, an elderly couple often finds it impossible to keep it because they can't pay the taxes. Five states have tried a property tax deferral plan for senior citizens that allows for nonpayment of taxes over the amount paid at age 65, up to the time the house is sold or bequeathed. At that time, the accumulated taxes are due. Some states have allowed deferral of all property taxes.

Pro: Deferral allows older people to live out their years in their own homes without worry about taxes. In the long range, local governments suffer no loss of revenues. Administration is relatively simple since liens are recorded anyway. The only paperwork would be a certification of eligibility.

Con: The elderly find this concept repugnant. In Oregon where the system is most used, there are only about 300 participants. The system makes old people feel as though they are leaving debts when they die. Whatever the equity arguments, the tax deferral idea is of extremely limited popular appeal. There is no help for renters.

In Nevada, the deferral concept could be enacted by law if it applies only to those in need thereby qualifying for the charitable exemption in the constitution. If it were to apply to anyone over a certain age without regard to income, it would require a constitutional amendment.

The deferral concept is really neither a reduction nor a redistribution device in the long run. In the short run, it may act as a redistribution device.

3. Tax Stabilization: As noted, a major problem with the present property tax arrangement is the fact that property values have been escalating faster than the general rate of inflation. To offset this situation, one idea considered by the California legislature in its recent tax relief session was to hold the assessment on a home at or near the level based on purchase price. This depressing effect on tax revenue growth would be partially offset by a fairly stiff real estate transfer tax of 5 percent on the profit on the sale of property. This same approach could be modified so that a person's property taxes did not increase by more than the increase in the Consumer Price Index. This modification combined with a real estate sales profit tax could bring relief to homeowners without decreasing local tax revenues.

Pro: This approach attacks the main target: real estate values escalating at a rate well in excess of general inflation, thereby increasing the proportion of household income that goes to property taxes. This plan could hold that proportion fairly constant which would also allow local revenue increases adequate to keep up with inflation. Ultimately, government will receive a good part of the tax it has waived by virtue of the tax on profits.

Con: There is no assistance for renters. There is no regard for need. Administration will be involved and costly. More than any other problem there would be a stultifying effect on the real estate market because to sell a home and move to another after several years would result in much higher taxes out of proportion to the relative value of the two homes. There will be a great potential for resentment among property owners when identical, neighboring homes are taxed at vastly different levels as will be the case when a new owner buys next to a long-time resident.

Tax stabilization would require a constitutional amendment in Nevada. It is basically a tax reduction device with no built-in redistribution feature.

4. Tax Freeze: This concept is also directed at the problem of the elderly on fixed incomes. The idea

is very simple in the two states where it is used (Connecticut and Minnesota). The dollar amount of the taxes paid on a home in the year following the attainment of age 65 by the owner becomes the base tax. The homeowner will continue to pay that base year tax so long as he stays in the same residence.

Pro: This solution is ideally suited to the problem of retired people on fixed incomes. It allows a person, when he retires, to plan accurately for future tax burdens. Administration would be simple.

Con: This system is not sensitive to need. It would provide the greatest tax savings to those with the highest value homes. As the years go by, losses to local government would mount and would never be recovered. The tax burden on others would have to increase.

If the tax freeze applied to the actual payment of taxes, this device would require a constitutional amendment in Nevada. If, on the other hand, the taxpayer paid the actual taxes and the state refunded the difference between actual taxes and base year taxes, then the system could be enacted by statute.

The tax freeze is a tax reduction device in its basic form and assuming surplus revenues elsewhere to replace those lost. If the state refunded a part of the taxes paid, then it would become a redistribution device with state revenues from some other source providing the refunds.

5. Differential Assessments: In this concept there is an underlying assumption that some classes of property ought to pay a greater proportionate share of property taxes. The California legislature passed tax reform legislation in March 1978 which includes a proposed constitutional amendment to allow the differential assessment of residential property occupied by owners. This is really another way of giving a tax break to owner-occupied residences and in that sense is similar

to the homestead exemption concept. In Nevada, for instance, this concept could mean raising the assessment ratio on nonresidential property to 40 percent and dropping it to 30 percent on residential. It could mean just dropping residential but that would result in a tax loss. To maintain a tax revenue level, the ratio for one class cannot be dropped without raising it for other classes.

Pro: The homeowner is the hardest hit property taxpayer. He has no one to pass increases on to. Businesses and rental property do. This sort of relief is direct and simple to administer. There is no certification or any other special procedure needed.

Con: This is a tax-shifting device. It cannot be shown that residences as a class pay too much of the property tax now. Based on services, many do not pay enough. This will shift a heavier burden to renters.

In Nevada, this concept would require a constitutional amendment.

By definition, differential assessments mean a redistribution of the tax burden.

6. Change the Assessment Ratio: The legislature has set a 35 percent assessment to full value ratio in Nevada. In some states it is 100 percent. In others, such as California, it is 25 percent. In Nevada, for every percentage point reduced on the present 35 percent, an effective tax reduction of 3 percent would be realized.

Pro: This is a simple and direct method. There would be no administrative burden at state or local level. This is across-the-board tax relief. Renters should benefit too.

Con: This device is not sensitive to need at all. In fact, the more valuable the property, the greater the tax relief in actual dollars.

In Nevada, the assessment ratio may be changed by statute.

A lowering of the assessment ratio is a tax reduction device.

7. The State's .25 Levy: The state currently takes .25 of the \$5 per \$100 tax rate. With the forecast surplus this biennium, there is some question as to whether or not the state needs all the approximately \$10 million per year derived from this levy. If the state does not need it all, it could reduce this levy thereby reducing every property owner's tax. For the \$60,000 home used as an example previously, for every nickel the state reduced its levy, the tax reduction would be \$10.50 or 1 percent of the total tax bill. If the entire .25 were dropped, the reduction would be 5 percent or \$52.50. Because the constitution grants all taxing power to the state and the state, by statute, delegates it to local government, the state could, by statute, reduce or eliminate the .25 state levy while preventing its use by a local entity.

Pro: This device provides across-the-board relief. It is simple and direct. It will not reduce local tax revenues. Renters should benefit also.

Con: This device is insensitive to need. It will provide the largest dollar amount reductions on the most valuable property.

In Nevada, this form of tax reduction can be accomplished by statute. Based on the assumption that the state can afford to provide this relief from surplus revenues, no redistribution of tax burden will occur.

8. Circuit Breakers: The most distinguishing feature of the circuit breaker, and the basis for the term, is the fact that it provides tax relief based upon the need of the taxpayer. Nevada's Senior Citizens'

Property Tax Assistance Act is a circuit breaker tax device. There are two forms of the circuit breaker. The first is a threshold approach which relieves something defined as "excess tax burden." Excess tax burden is tax liability which exceeds some percentage of income. The percentage can be adjusted so that wealthier households pay a higher percentage of income for tax. The other approach is the percentage-of-tax-liability circuit breaker in which an acceptable percentage of tax at each income level is established. The difference between these two is best illustrated by example.

Home valued at	\$40,000
Assessed Valuation	\$14,000
Tax at \$5 Rate	\$ 700
Household Income	\$15,000

Threshold Approach based on a 3 percent of gross income threshold for property taxes at the \$15,000 gross income level.

3 percent of \$15,000 = \$450
Excess Tax Liability = \$250

Percentage of Tax Approach based on 80 percent of tax bill at the \$15,000 gross income level.

80 percent of \$700 = \$560
Excess Tax Liability = \$140

Either circuit breaker approach can be varied in infinite ways to accomplish what is deemed as greater tax equity.

The Nevada Senior Citizens' Property Tax Assistance Act uses the percentage of tax approach with a dollar cap of \$300.

Pro: Circuit breakers are sensitive to taxpayer need and, usually, the greater the need, the greater the tax relief. The circuit breaker can be designed to

include renters as is the current Nevada law for senior citizens. Since Nevada is already administering a circuit breaker law, additional participants would not be a great administrative burden. If a circuit breaker is state funded, no loss of local revenue occurs.

Con: Definition of eligibility in any need-based tax relief is difficult and makes administration more expensive. In particular, defining income and evaluating net worth can be very difficult and open the system to fraud possibilities.

In Nevada, the circuit breaker device may be accomplished through statute since the circuit breaker is, by definition, a need-based concept thereby qualifying under the charitable exemption in the constitution.

To the extent that the state funds a circuit breaker from existing general fund revenues, the circuit breaker is a property tax reduction. If the state or local governments funded a circuit breaker from existing or increased property taxes, then the circuit breaker is a tax redistribution.

9. State Funding of Local Programs: The state currently funds a large part of the cost of the public school system. Over half of such costs in 1977-78 came from the state distributive school fund. The school districts still take over 43 percent of all property taxes statewide with the counties second at almost 29 percent. If the state has the resources to increase aid to local schools, the portion of the property tax rate going to the schools in each county could be reduced and reserved by the state. For every \$10 million added to the distributive school fund, property taxes for schools can be reduced about 10 percent without subtracting from the quality of the schools. A 10 percent reduction in school taxes, on the average, will be a 4.3 percent reduction on the property tax bill. The state now requires each county to levy .11 for care of indigents. The state administers the program anyway. If the state also funded it, the .11 could be dropped from the county tax rate.

Pro: This approach simply extends a trend of recent years. The greater the state funding, the more equal is the educational opportunity throughout the state. The tax relief brought about would be direct and simple with no administrative burden. The state administers aid to indigents anyway so it is logical for the state to fund it too.

Con: This device is insensitive to need. It increases the state influence over local school districts by making an even greater share of school revenue come from the state. There will be no direct benefit to renters.

This device can be accomplished by statute.

To the extent that the state has excess revenues that can be diverted into the distributive school fund, this approach will result in tax reduction. If the state has to raise other taxes, it would amount to redistribution.

Conclusion

There is no property tax relief device that meets all desired criteria. Those that are simple and easy to administer are not sensitive to need. Those which are sensitive to need are always a considerable administrative burden.

Generally, there is no painless tax relief unless vast surplus revenue is available. Otherwise, assuming constant or, more likely, growing government service demands, a reduction of one person's taxes will be an increase of another's. Even if property tax relief is funded from other state revenues that are in excess of expectations and expenditures, someone paid taxes to produce the excess that will fund property tax relief. The question then is whether some taxes are more equitable and less painful than other taxes thereby suggesting a shift from the more painful and less equitable to the less painful and more equitable.

The discussion comes full circle and the conclusion is that the property tax, in general, is equitable and rather progressive. The exception to this general observation is the very low income household and those on fixed income. The least expensive and most efficient property tax relief would be directed at those whose property tax burdens have gone beyond the ability to pay. In addition, if it can be demonstrated that the recipients of property tax revenues will receive more than required for needed services, some across-the-board tax relief could be combined with specific relief.

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