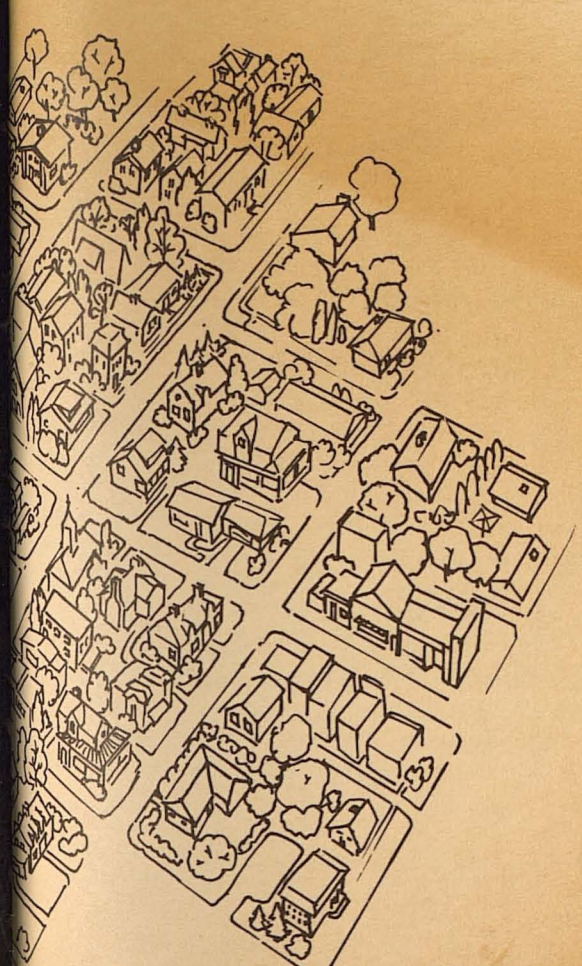
PROPERTY TAXES . . . Reform, Relief, Repeal?



North Central Regional Extension Publication 39-Revised 1980
Extension Bulletin 447

Sponsored by the Extension services of Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin.

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Preface

The property tax is one of the oldest and most criticized forms of taxation. Despite criticism over the years, it is still the most important source of tax revenue for most local governments in the United States. Efforts to reform property tax administration, provide tax relief to property owners, and repeal property taxes on certain classes of property will continue for years to come.

This publication is designed to examine these issues in the context of the policy options that are available. The purpose is to educate rather than to advocate any particular course of action.

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The North Central Public Policy Education Committee delegated the responsibility for revising this publication to a subcommittee. Members of the subcommittee were: Arley D. Waldo, University of Minnesota, Chair; Everett E. Peterson, University of Nebraska; and Norbert A. Dorow, North Dakota State University.

Chapter 1

PROPERTY TAXATION IN THE UNITED STATES

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The property tax is one of the world's oldest forms of taxation—and perhaps the most disliked. Probably no major tax has been subjected to more intensive and sustained criticism. Modern-day tax authorities still quote with approval the scathing charge made in 1895 that "the general property tax as actually administered is beyond all doubt one of the worst taxes known in the civilized world."[1] Yet, the property tax persists as an important source of government revenue. Today, property taxes account for nearly one out of every six tax dollars collected in the United States. Property tax collections have more than doubled in the past 10 years. If property taxes continue to increase at the pace of the past decade, property tax collections will exceed $100 million by the mid-1980s.

The principal reason for property tax levies is to raise revenue to finance local units of government. But property taxes also influence the economic decisions and well-being of households and businesses. Property taxes may distort, or be purposely used to influence, the way in which land and other natural resources are used, the location of economic activity, the character of residential neighborhoods, and the way in which entire communities develop.

Major Taxes Affecting Property

Several kinds of taxes may be imposed as a condition of continued property ownership or when property rights are transferred. By far the most important tax on property in the United States is the ad valorem (according to value) property tax levied by state and local governments. However, certain classes of property may be subject to special or selective property taxes or to taxes imposed in lieu of property taxes. In addition, some kinds of local public improvements may be financed by special assessments against property. The transfer of property rights may involve capital gains taxes, inheritance and estate taxes, gift taxes, and documentary or recording taxes.

The ad valorem property tax is essentially an annual charge levied against the assessed value of all taxable property. Property taxes generally constitute a claim against the value of taxed property, and continued failure to pay property taxes usually leads to a loss of property rights.

A tax imposed on all forms of wealth, both tangible and intangible, levied at a uniform rate, and based on the prevailing market value of all property would be a "general" property tax. While the term general property tax is frequently used, no state in this country has a truly general property tax. In every state, some types of property are completely or partially exempt from taxation or are taxed at rates which differ from the rates applied to other classes of property.

In addition to ad valorem property taxes, real estate may also be subject to special assessments. A special assessment is a benefit tax imposed to help finance public improvements that are likely to increase property values. Special assessments are widely used by municipalities to finance sewers, water mains, streets, sidewalks, parks, and other improvements. Special-purpose units of government also rely heavily on special assessments to finance irrigation, drainage, flood protection, and other projects.

While the ad valorem property tax is principally a local tax, certain classes of property are often assessed and sometimes taxed at the state level rather than the local level. States typically assess airline and railroad property, pipelines, electric distribution lines, and deposits of coal, petroleum, and metallic ore. In some states, the assessed value of these properties becomes a part of the local tax base and subject to local taxation. Other states impose special state taxes on such property. These state-collected taxes may then either be retained by the state or turned over to the localities that are affected.

States also may impose certain taxes either in lieu of property taxes or in addition to them. Registration and license fees on automobiles, trucks, boats, recreational vehicles, and mobile homes are examples. Several states levy severance taxes in connection with the mining, extraction, or harvesting of natural resources such as metallic ores, coal, petroleum, natural gas, and timber.

[1] Edwin R. A. Seligman, "The General Property Tax," in *Essays in Taxation*, 9th ed. (New York: Macmillan, 1921), p. 62.

Evolution of Property Taxes

Property taxation in the United States dates from the colonial period. Although initially influenced to some extent by the tax systems of England and Europe, property taxes as they exist today in this country are largely an American invention.[2] In the colonies, property taxes were used to supplement poll taxes and other sources of public revenue. Initially, the property tax was a "classified" tax in which only certain classes of property were subject to taxation and tax rates often varied according to the type of property. The property tax slowly evolved into a more general tax that was applied to more classes of property which were taxed at a uniform rate according to market value.

The trend toward a general property tax was reversed long ago. States have increasingly turned away from the rules of uniformity of property tax rates and universal taxation of property and moved toward providing differential tax treatment based on the type, use, and ownership of property.

For more than a century, property taxes have been exclusively a source of state and local government revenue. The federal government has levied a property tax on only three occasions, the most recent during the Civil War. Use of the property tax as a source of federal revenue has been effectively barred by the constitutional requirement that all direct federal taxes be levied on the states in proportion to their population.

State and local property tax collections increased from less than $1 billion in 1902 to $57 billion by 1976 (table 1). However, other taxes have increased even faster. In the early 1900s, property taxes accounted for more than half of the total tax revenue of federal, state, and local governments (table 2). At that time, local governments were fiscally more important than either the federal or state governments, and they received most of their tax revenue from property taxes.

The relative importance of the property tax declined considerably in the 1930s as states began to rely more heavily on other tax sources. During the 1930s, 24 states adopted general sales taxes and 16 states adopted individual income taxes. The proportion of total tax revenue generated by property taxes fell still further as federal taxes shot upward during World War II. Until 1942, the property tax was the single most important source of tax revenue in the nation. By 1952, property taxes accounted for only about 11 percent of the nation's total tax revenue. In recent years, the overall importance of property taxes has increased to around 15 percent of all taxes.

Table 1. Property Tax Collections in the United States, Selected Years, 1902 to 1976

Year	Amount			Percent of Total	
	State and Local	State	Local	State	Local
	Mil.Dol.	Mil.Dol.	Mil.Dol.	Percent	Percent
1902	706	82	624	11.6	88.4
1913	1,332	140	1,192	10.5	89.5
1927	4,730	370	4,360	7.8	92.2
1936	4,093	228	3,865	5.6	94.4
1946	4,986	249	4,737	5.0	95.0
1956	11,749	467	11,282	4.0	96.0
1966	24,670	834	23,836	3.4	96.6
1976	57,001	2,118	54,884	3.7	96.3

Source: U.S. Bureau of the Census, *Census of Governments: 1967*, Vol. 6, No. 5, *Historical Statistics on Governmental Finances and Employment*, tables 4, 5, and 6; and U.S. Bureau of the Census, *Governmental Finances in 1975-76*, GF 76, No. 5, table 4.

Table 2. Importance of Property Taxes in the United States, Selected Years, 1902 to 1976

Year	Property Tax Revenue as a Percentage of—			
	Federal, State, and Local Tax Revenue	State and Local Tax Revenue	State Tax Revenue	Local Tax Revenue
	Percent	Percent	Percent	Percent
1902	51.4	82.1	52.6	88.6
1913	58.7	82.8	46.5	91.1
1927	50.0	77.7	23.0	97.3
1936	38.7	61.1	8.7	94.7
1946	10.8	49.4	5.0	91.9
1956	12.8	44.6	3.5	86.8
1966	15.3	43.6	2.8	87.1
1976	15.9	36.3	2.4	81.2

Source: U.S. Bureau of the Census, *Census of Governments: 1967*, Vol. 6, No. 5, *Historical Statistics on Governmental Finances and Employment*, tables 4, 5, and 6; and U.S. Bureau of the Census, *Governmental Finances in 1975-76*, GF 76, No. 5, table 4.

Property Taxation and Local Government Finance

The property tax in the United States is now almost exclusively imposed and administered by local units of government. Nearly all state governments have largely withdrawn from the property tax field. Nationally, only about 2 percent of all state tax revenue comes from property taxes. In 1976, only four states—Alaska (51.2 percent), Maine (24.8 percent), Washington (14.7 percent), and Arizona (11.3 percent)—received as much as 10 percent of their tax revenue from property taxes.[3] Most state governments collect little if any revenue from property taxes.

Local governments levy nearly all property taxes, and local officials assess most property available for local taxation. According to the 1977 Census of Governments, there are nearly 80,000 local governmental units in the United States. Most of these local governments have legal authority to levy property taxes.

The general revenue of local governments comes from two major sources: (1) intergovernmental transfers (state and federal grants-in-aid); and (2) local sources, including local taxes, charges for public services (special assessments, toll charges, tuition fees, etc.), and miscellaneous sources such as interest earnings on deposits and securities.[4] Nationwide, the prop-

[2] For a brief history of property taxation in the United States, see Jens P. Jensen, *Property Taxation in the United States* (Chicago: University of Chicago Press, 1931), chapter 2.

[3] In Alaska, the large proportion of state revenue from property taxes was the result of a special state property tax on oil and gas properties and reserves effective January 1, 1976. Only 3 percent of state tax collections in Alaska came from property taxes in 1975.

A state-imposed uniform property tax was enacted in Maine in 1973. This tax, adopted as part of a new school financing plan, was repealed at a special referendum in December 1977.

[4] General revenue includes all revenue except the receipts of publicly operated utilities, liquor stores, and insurance trust funds.

erty tax is the largest single source of revenue for local governments. However, the overall importance of local property taxes has declined somewhat. Many states have attempted to slow down increases in local property taxes by limiting local property tax levies, increasing state aid to local units, and providing alternative local taxes. In addition, federal aid—including federal general revenue sharing payments—is now more important in the budgets of local governments.

Between 1966 and 1976, the total general revenue of all local governments in the United States climbed from around $53 billion to nearly $163 billion, a three-fold increase in 10 years (table 3). Some major changes in the relative importance of different revenue sources accompanied this sharp rise. The share of local government revenue from local sources dropped from 67 percent in 1966 to 57 percent in 1976, and the share from state and federal aid increased from 33 percent to 43 percent. States still provide most of the intergovernmental revenue received by local governments, but the share coming from the federal government has been increasing. Partly because of the federal general revenue sharing program initiated in 1972, the proportion of intergovernmental revenue received by local governments that came directly from the federal government increased from around 8 percent in 1966 to almost 20 percent in 1976.

Taxes accounted for about 72 percent of all general revenue from local sources in 1976, and nontax sources for about 28 percent. Local nontax sources of revenue have been increasing in importance. Local property taxes have declined in importance as a source of local tax revenue as local governments have increased their reliance on other taxes.

The extent to which local governments depend on property taxes varies among states and by type of local government. Based on statewide averages for 1976 for all units of local government, property taxes accounted for 90 percent or more of all local tax revenue in 23 states (table 4). In only 14 states did property taxes account for less than 80 percent of all local tax revenue.

Table 3. General Revenue of Local Governments by Source, United States, 1966 and 1976

Source	Amount		Percentage Distribution	
	1966	1976	1966	1976
	Mil.Dol.	Mil.Dol.	Percent	Percent
All Sources				
State and Federal Aid	17,768.1	69,745.5	33.4	42.8
Local Sources	35,404.3	93,185.7	66.6	57.2
Total	53,172.4	162,931.3	100.0	100.0
State and Federal Aid				
State Aid[a]	16,390.5	56,169.1	92.2	80.5
Federal Aid	1,377.6	13,576.4	7.8	19.5
Total	17,768.1	69,745.5	100.0	100.0
Local Sources				
Taxes	27,360.8	67,557.4	77.3	72.5
Charges and Misc.	8,043.5	25,628.3	22.7	27.5
Total	35,404.3	93,185.7	100.0	100.0
Local Taxes				
Property Taxes	23,836.1	54,883.6	87.1	81.2
Other Taxes	3,524.7	12,673.8	12.9	18.8
Total	27,360.8	67,557.4	100.0	100.0

[a]Includes federal grants-in-aid that are paid to state governments and then passed on to local units.

Source: U.S. Bureau of the Census, *Governmental Finances in 1965-66*, GF 13, table 17, and U.S. Bureau of the Census, *Governmental Finances in 1975-76*, GF 76, No. 5, table 17.

Table 4. Importance of Property Taxes as a Source of Tax Revenue for State and Local Governments, by State, United States, 1976.

State	Property Tax Revenue as a Percentage of—		
	State and Local Tax Revenue	State Tax Revenue	Local Tax Revenue
	Percent	Percent	Percent
New England States			
Maine	44.2	24.8	99.1
New Hampshire	60.9	3.0	98.1
Vermont	41.5	0.2	98.8
Massachusetts	47.7	a	99.4
Rhode Island	41.4	1.4	99.1
Connecticut	47.4	—	99.1
Middle Atlantic States			
New York	36.1	0.3	68.5
New Jersey	56.3	3.1	90.9
Pennsylvania	25.7	1.2	67.8
East North Central States			
Ohio	38.2	3.0	77.7
Indiana	38.4	1.3	97.5
Illinois	36.9	0.1	82.6
Michigan	43.3	3.2	92.8
Wisconsin	36.5	5.2	98.4
West North Central States			
Minnesota	30.9	0.1	96.4
Iowa	39.6	a	98.2
Missouri	34.2	0.3	72.4
North Dakota	31.8	0.6	95.3
South Dakota	48.3	—	91.1
Nebraska	48.5	a	93.0
Kansas	42.1	1.6	95.2
South Atlantic States			
Delaware	16.9	—	85.4
Maryland	29.4	3.1	65.9
District of Columbia	22.7	—	—
Virginia	28.3	1.1	68.3
West Virginia	18.1	a	82.0
North Carolina	24.7	1.6	82.5
South Carolina	23.7	0.4	92.9
Georgia	32.4	0.4	83.5
Florida	33.8	2.0	84.9
East South Central States			
Kentucky	19.1	2.7	67.4
Tennessee	26.3	—	67.8
Alabama	12.6	2.5	42.1
Mississippi	22.5	0.4	94.2
West South Central States			
Arkansas	22.3	0.2	91.3
Louisiana	14.8	a	50.4
Oklahoma	23.4	—	73.7
Texas	36.7	0.9	86.2
Mountain States			
Montana	49.4	6.0	96.4
Idaho	32.2	0.1	97.5
Wyoming	41.5	3.6	94.9
Colorado	37.3	0.2	76.3
New Mexico	17.1	2.4	85.7
Arizona	38.6	11.3	81.8
Utah	29.0	a	83.2
Nevada	33.2	6.8	70.7

Table 4 continued

State	Property Tax Revenue as a Percentage of— State and Local Tax Revenue	State Tax Revenue	Local Tax Revenue
	Percent	Percent	Percent
Pacific States			
Washington	32.4	14.7	74.3
Oregon	47.3	a	95.4
California	43.1	3.5	85.7
Alaska	55.3	51.2	75.0
Hawaii	18.6	—	81.0
United States	36.4	2.4	81.2

—Represents zero
[a]Less than 0.05 percent
Source: U.S. Bureau of the Census, *Governmental Finances in 1975-76*, GF 76, No. 5, table 17.

Table 5. General Revenue of Local Governments from Property Taxes, by Type of Government, United States, 1976

Type of Government	Amount	Percentage Distribution
	Mil.Dol.	Percent
School Districts	24,399.0	44.5
Municipalities	14,165.2	25.8
Counties	11,582.0	21.1
Townships	3,369.2	6.1
Special Districts	1,368.0	2.5
All Local Governments	54,883.6	100.0

Note: Details may not add to totals because of rounding.
Source: U.S. Bureau of the Census, *Governmental Finances in 1975-76*, GF 76, No. 5, table 16.

Among local governments, school districts receive the largest share of property tax revenue, more than two-fifths of the total in 1976 (table 5). The dependence of local governments on the property tax varies by type of government (table 6). School districts receive most of their revenue from local property taxes and state school aids. Counties and municipalities rely on property taxes for a little less than one-third of their total general revenue. Townships, found in only 21 states, receive more than half of their revenue from property taxes. Property taxes are much less important to special districts. More than half of the special districts in the country do not have legal authority to levy property taxes.

Local governments usually overlap one another, but their decisions concerning the amount of property taxes to levy are usually made independently. Thus, the property tax statement received by an individual taxpayer typically includes an aggregation of taxes levied separately by the county, the city or township, the local school district, and perhaps a number of special districts.

For most local governments, the property tax is a residual tax used to fill the gap between the amount of revenue available from other sources and the total revenue needed to meet local budget requirements. When the growth of revenue from other sources fails to keep pace with increasing demands for local public services and inflation, property taxes almost inevitably rise unless increases are legally restricted. Without other sources of local tax revenue available, the choices open to local officials are to increase property taxes, cut planned expenditures, or increase charges for public services. As demands for local services increase, the effect on local property tax levies is largely determined by decisions at the state and federal level concerning grants-in-aid to local governments, availability of non-property tax sources of local revenue, and limitations on local property tax levies.

Recent Trends

Many states have attempted to improve their property tax systems in recent years and to de-emphasize property taxes as a source of state-local revenue. Between 1966 and 1976, the proportion of state and local general revenue originating from property taxes fell from 30 percent to 22 percent. This reduction reflects both an increase in the relative importance of federal grants-in-aid to state and local governments and an increase in the reliance of state and local governments on non-property tax sources of revenue.

States have increasingly turned to non-property tax sources of revenue to finance state and local public services. From 1966 to 1976, state and local taxes other than property taxes increased at an average annual rate of 12 percent per year, while property taxes increased an average of less than 9 percent per year (table 7). During this period, property taxes increased less rapidly than other state and local taxes in all but five states (Alaska, Georgia, South Carolina, Vermont, and Washington). De-emphasis of property taxes has been particularly striking in some states. In the District of Columbia, Minnesota, Nebraska, North Dakota, and Utah, state and local taxes other than property taxes increased at least twice as fast as property taxes be-

Table 6. Percentage Distribution of the General Revenue of Local Governments by Source, by Type of Government, United States, 1976

Source	School Districts	Municipalities	Counties	Townships	Special Districts	All Local Governments
	Percent	Percent	Percent	Percent	Percent	Percent
Property Taxes	41.4	25.6	31.4	56.1	14.2	33.7
Other Local Taxes	1.0	16.6	6.9	4.9	0.7	7.8
Local Nontax Sources	9.9	19.5	18.3	10.6	57.2	15.7
State Aid	46.2	24.9	35.6	21.2	8.2	34.5
Federal Aid	1.5	13.4	7.9	7.2	19.7	8.3
All Sources	100.0	100.0	100.0	100.0	100.0	100.0

Note: Details may not add to totals because of rounding.
Source: U.S. Bureau of the Census, *Governmental Finances in 1975-76*, GF 76, No. 5, table 16.

Table 7. Change in State and Local Government Revenue from Property Taxes and Other Taxes, by State, United States, 1966 to 1976

State	Average Annual Rate of Change, 1966-76		Change in Other Tax Revenue Relative to Change in Property Tax Revenue[a]
	Property Tax Revenue	Other Tax Revenue	
	Percent	Percent	Percent
New England States			
Maine	10.0	12.2	122
New Hampshire	10.7	11.9	111
Vermont	12.0	10.9	91
Massachusetts	9.4	13.4	143
Rhode Island	9.0	10.2	113
Connecticut	9.5	11.1	117
Middle Atlantic States			
New York	9.4	11.5	122
New Jersey	9.8	13.7	140
Pennsylvania	7.4	11.6	157
East North Central States			
Ohio	6.3	12.4	197
Indiana	5.7	10.4	182
Illinois	7.1	13.3	187
Michigan	10.1	10.2	101
Wisconsin	7.7	11.4	148
West North Central States			
Minnesota	5.5	14.2	258
Iowa	5.9	11.1	188
Missouri	7.9	10.3	130
North Dakota	4.9	13.2	269
South Dakota	6.6	9.8	148
Nebraska	6.7	17.8	266
Kansas	6.6	9.6	145
South Atlantic States			
Delaware	8.6	10.9	127
Maryland	8.5	14.7	173
District of Columbia	5.2	11.9	229
Virginia	9.8	13.6	139
West Virginia	7.0	12.1	173
North Carolina	10.2	11.0	108
South Carolina	12.4	11.3	91
Georgia	12.4	11.1	90
Florida	10.7	13.3	124
East South Central States			
Kentucky	8.1	13.0	160
Tennessee	9.4	11.2	119
Alabama	6.1	10.8	177
Mississippi	8.2	11.0	134
West South Central States			
Arkansas	8.4	10.6	126
Louisiana	6.2	11.2	181
Oklahoma	6.0	10.9	182
Texas	9.5	13.6	143
Mountain States			
Montana	8.7	11.7	134
Idaho	7.2	10.7	149
Wyoming	9.4	14.6	155
Colorado	8.5	12.8	151
New Mexico	6.9	10.9	158
Arizona	11.1	14.8	133
Utah	6.0	12.0	200
Nevada	10.3	13.6	132
Pacific States			
Washington	10.6	10.0	94
Oregon	10.8	10.9	101
California	9.1	12.2	134
Alaska	35.9	18.5	52
Hawaii	10.5	12.6	120
United States	8.7	12.0	138

[a]Calculated as the average annual rate of change of "other" tax revenue as a percentage of the average annual rate of change of property tax revenue. The larger the increase in other tax revenue relative to property tax revenue, the larger this figure will be.

Source: U.S. Bureau of the Census, *Governmental Finances in 1965-66*, GF 13, table 17; and U.S. Bureau of the Census, *Governmental Finances in 1975-76*, GF 76, No. 5, table 17.

tween 1966 and 1976. In 13 other states, the rate of increase in non-property tax revenue was at least one and a half times the rate of increase in property tax collections.

States also have moved to improve property tax administration. Efforts to improve property tax administration have included:

1. Appointment rather than election of property tax assessors.
2. Requirements for the training and certification of property tax assessors.
3. Use of assessment-sales ratio studies as a check on the quality of local assessments.
4. Use of tax maps, uniform appraisal manuals, and data processing equipment.
5. Measures to streamline the process for property tax appeals.

Two major changes in state property tax systems are especially noteworthy: (1) the adoption of "circuit breaker" property tax relief programs and (2) provisions for the differential assessment of farm and open space land.

Maryland was the first state to adopt provisions for the preferential tax treatment of farmland (1956). Maryland's original use-value assessment law provided that land "actively devoted to farm or agricultural use will be assessed on the basis of such use, and shall not be assessed as if subdivided or on any other basis."[5] Provisions for use-value assessment and deferred taxation of farm and open space land have proven popular. As of July 1, 1976, 41 states had adopted provisions for differential assessment of farmland.[6]

Every state provides some type of property tax relief for the elderly, and many states have extended property tax relief to all low-income homeowners and renters through "circuit break" provisions. First enacted by Wisconsin in 1964, a circuit breaker is designed to prevent residential property taxes from exceeding a certain percentage of household income. By 1977, 29 states and the District of Columbia had implemented circuit-

[5]1956 Maryland Laws, Chapter 9, Section 1, as cited in Raleigh Barlowe and Theodore R. Alter, *Use-Value Assessment of Farm and Open Space Lands*, Research Report 308 (East Lansing, Michigan: Michigan State University, Agricultural Experiment Station, September 1976), p. 4.

[6]Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, 1976-77 Edition, Vol. 2— *Revenue and Debt* (Washington: U.S. Government Printing Office, March 1977), p. 126.

breaker property tax relief programs.[7] Nationally, nearly $1 billion in circuit-breaker tax relief was paid out in 1977.[8]

Efforts to improve property tax administration and to provide property tax relief are important policy issues across the nation. The chapters that follow discuss the operation of the property tax and some of the major issues concerning the role of the property tax in financing state and local public services.

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[7] Advisory Commission on Intergovernmental Relations, *Intergovernmental Perspective,* Vol. 4, No. 3 (Summer 1978), p. 11.

[8] Ibid. In 1977, an average of $185.72 was paid to 5.1 million claimants at an average per capita cost of $6.90.

Chapter 2

THE PROPERTY TAX IN OPERATION

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Property tax systems differ somewhat from state to state, but their main features are generally similar. This chapter describes the operation of the property tax and some of the criteria by which property tax systems may be evaluated.

The Tax Base

Property taxes are levied on the assessed value of all property that is not exempt from taxation. Taxable property may include both real property and personal property. Real property consists of land and improvements such as homes, buildings, etc. Personal property includes tangible personal property (machinery, household furnishings, business inventories, etc.) and intangible personal property (bank deposits, stocks, bonds, etc.).

The assessed value of nonexempt property represents the property tax base. According to the 1977 Census of Governments, the gross assessed value of property in the United States totaled $1,216 billion in 1976. However, this included $39 billion in property that was legally exempt from local property taxes. The net assessed value of all nonexempt property available for local taxation in 1976 was $1,178 billion, more than double the value of 10 years earlier. Locally assessed real estate accounted for 81 percent of the total net valuation in 1976.

States exclude certain classes of property from the tax base through constitutional and statutory provisions. Provisions for complete or partial tax exemption of property vary widely from state to state. Federal constitutional provisions prevent states and localities from taxing the property of the federal government. In general, property owned by all governmental units is totally exempt from taxation, and so is much of the property owned by religious and charitable organizations, educational institutions, and nonprofit hospitals.

Many states exempt certain classes of property from the local property tax because other taxes are levied against the property or business. The use of special or selective property taxes or other taxes in lieu of the property tax is most common in the taxation of public utilities.

A few states exempt new industrial plants for a limited period of time as an inducement to attract new industry. Exemption of some types of property may be used to encourage certain activities; for example, more than half of the states exempt facilities used for pollution control and abatement from property taxation.

Taxation of personal property varies widely. Four states exempt all tangible personal property from local taxation, according to the 1977 Census of Governments. A few states tax most kinds of tangible personal property, but most states provide for partial or complete exemption of some classes of personal property. For example, in all but four states, commercial and industrial personal property is subject to taxation. However, about half of the taxing states provide for partial exemption of such property. Agricultural personal property is completely exempt from taxation in nine states, and 20 of the 42 taxing states provide for partial exemption of agricultural personalty. About two-thirds of the states exempt all intangible personal property.[1]

Partial tax exemption or special tax treatment is often accorded certain classes of property on the basis of ownership or use. Partial homestead exemptions for veterans, the elderly, disabled persons, and low-income homeowners are examples. About half of the states now provide property tax relief through the use of "circuit-breaker" tax credits. Some states also use tax credits to offset part of the property taxes presumed to be passed on to renters. Most states authorize special treatment of certain agricultural land through use-value assessment, deferred taxation, or various kinds of contracts and agreements.[2]

The property tax base is reduced as a result of total exemption of certain classes of property and partial exemption of other classes. Little information is available on the value of property that is completely exempt

[1]For a discussion of the taxation of personal property, see Chapter 5.
[2]For a discussion of use-value assessment of agricultural land, see Chapter 4.

from taxation (property owned by government, religious groups, educational institutions, etc.). Among a sample of 17 states and the District of Columbia, the 1977 Census of Governments found that government holdings represented more than half of the value of all property excluded from taxation. The amount by which partial exemptions reduce the tax base varies from state to state. Among 27 reporting states, partial exemptions (e.g., homestead exemptions) amounted to more than 10 percent of the gross assessed valuation in six states.

More than four-fifths of the property tax base in the United States consists of real property. The gross assessed value of locally-assessed real estate totaled about $983 billion in 1976. The estimated composition of the real estate tax base is shown in table 8. Nonfarm residential property accounted for around 60 percent of the total. The property tax in the United States is mostly a tax on real estate, and residential property is the largest single component of the real estate tax base.

Property Tax Rates

Property tax rates differ considerably between states and between local taxing jurisdictions within states. The property tax rate is usually expressed in mills—one mill equals $1 per $1,000 of assessed valuation, or in percentage terms, one-tenth of 1 percent. In comparing property tax rates, it is important to distinguish between "nominal" tax rates and "effective" tax rates. The nominal tax rate is the dollar amount of property taxes to be collected expressed as a percentage of the assessed value of taxable property. The effective tax rate is the dollar amount of property taxes to be collected expressed as a percentage of the actual market value of taxable property. Because property generally is assessed for tax purposes at less than actual market value, nominal tax rates typically exceed effective tax rates. The extent to which nominal and effective property tax rates differ depends on the assessment level. The assessment level is the assessed value of taxable property expressed as a percentage of actual value of taxable property. State provisions for homestead exemptions, classification of property, etc., also cause nominal and effective tax rates to differ.

Table 8. Estimated Composition of the Real Estate Tax Base, United States, 1976

Type of Real Property	Gross Assessed Value	
	Amount	Percentage Distribution
	Bil. Dol.	Percent
Nonfarm residential	584.6	59.5
Commercial and industrial	233.8	23.8
Acreage and farms	119.6	12.2
Vacant lots	37.7	3.8
Other	7.1	0.7
TOTAL	982.9	100.0

Note: Details may not add to totals because of rounding. Excludes state-assessed property.
Source: U.S. Bureau of the Census, *Census of Governments: 1977*, Preliminary Report No. 2, Assessed Valuations for Local General Property Taxation, p. 3.

The relationship between level of assessment, nominal tax rates, and effective tax rates is illustrated in table 9. In this hypothetical example, it is assumed that five different taxing jurisdictions each have a property tax base, measured in terms of actual market value, of $100,000 and that each levies property taxes of $2,000. Thus, the effective tax rate is 2 percent in each district. However, because of differences in assessment levels, nominal tax rates vary. The lower the assessment level, the higher the nominal tax rate must be to raise a fixed amount of revenue. Obviously, a comparison of nominal property tax rates in these taxing jurisdictions would give a misleading notion of differences in property tax levels. Property tax levels should be compared on the basis of effective tax rates.

Table 9 also may be used to show that an increase in the level of assessment will not, in itself, change the effective property tax rate. For example, if the assessment level in Jurisdiction A is raised from 20 to 40 percent (as shown for B), the nominal tax rate would fall from 10 percent (100 mills) to 5 percent (50 mills); but the effective tax rate would remain unchanged. The effective rate of taxation is determined by only two factors: (1) the amount of property taxes to be collected and (2) the actual market value of taxable property.

Variations in average state-wide effective property tax rates for owner-occupied single-family homes and farm real estate are shown in table 10. In general, residential property tax rates tend to be highest in the northeastern part of the nation and lowest in the South. Farm real estate tax rates tend to be lower in the southern and mountain states than elsewhere.

Some states have homestead tax provisions which cause effective tax rates to vary with the market value of the home. For example, the statewide average effective tax rate in Minnesota in 1972 ranged from $1.58 per $100 of market value for homes with a market value

Table 9. Relationship Between Assessment Levels, Nominal Tax Rates, and Effective Tax Rates

Taxing jurisdiction	Property tax levy	Actual market value of taxable property	Assessed value of taxable property	Assessment Level[a]	Nominal tax rate[b]	Effective tax rate[c]
	Dollars	Dollars	Dollars	Percent	Percent	Percent
A	2,000	100,000	20,000	20	10	2
B	2,000	100,000	40,000	40	5	2
C	2,000	100,000	60,000	60	3⅓	2
D	2,000	100,000	80,000	80	2½	2
E	2,000	100,000	100,000	100	2	2

[a]Assessment level is the ratio of the assessed value of taxable property to the actual market value of taxable property.
[b]Nominal tax rate is the ratio of the property tax levy to the assessed value of taxable property.
[c]Effective tax rate is the ratio of the property tax levy to the actual market value of taxable property.

of $10,000 to $2.72 per $100 for homes valued at $50,000. In this case, homes worth $50,000 were taxed at a rate 72 percent higher than the average tax rate for a $10,000 home. In some instances, homestead tax provisions result in a much narrower range in tax rates. In Nebraska, for example, the effective tax rate was $2.06 per $100 for a $10,000 home and $2.20 for a $50,000 home, a difference of only 7 percent.

Several factors cause property tax rates to vary. Some states rely more heavily than others on property taxes to finance public services. In addition, the property tax base and the level of public services provided may vary among states and among localities within a state.

Table 10. Effective Property Tax Rates on Owner-Occupied Single-Family Homes and on Farm Real Estate

State	Property Taxes per $100 of Actual Market Value	
	Owner-Occupied Single-Family Homes[a]	Farm Real Estate[b]
	Dollars	Dollars
New England States		
Maine	1.86	1.13
New Hampshire	NA	1.14
Vermont	NA	1.22
Massachusetts	3.26	1.70
Rhode Island	NA	1.31
Connecticut	1.94	.91
Middle Atlantic States		
New York	2.56	1.62
New Jersey	3.15	.96
Pennsylvania	1.71	.83
East North Central States		
Ohio	1.29	.75
Indiana	1.64	.57
Illinois	2.21	.95
Michigan	2.38	1.61
Wisconsin	2.63	1.56
West North Central States		
Minnesota	1.58	.82
Iowa	2.20	.83
Missouri	1.85	.57
North Dakota	1.53	.66
South Dakota	2.14	.94
Nebraska	2.50	.91
Kansas	1.55	.75
South Atlantic States		
Delaware	0.92	.16
Maryland	2.01	.50
District of Columbia	1.78	—
Virginia	1.32	.45
West Virginia	0.78	.18
North Carolina	1.51	.41
South Carolina	1.07	.35
Georgia	1.33	.54
Florida	1.18	.67
East South Central States		
Kentucky	1.23	.39
Tennessee	1.31	.46
Alabama	0.75	.14
Mississippi	1.12	.32
West South Central States		
Arkansas	1.41	.37
Louisiana	0.64	.24
Oklahoma	1.27	.38
Texas	2.06	.44
Mountain States		
Montana	1.60	.61
Idaho	1.86	.62
Wyoming	1.12	.43
Colorado	1.99	.52
New Mexico	1.56	.25
Arizona	1.54	.81
Utah	1.20	.61
Nevada	1.53	.72
Pacific States		
Washington	1.86	.71
Oregon	2.18	1.03
California	2.08	1.56
Alaska	1.73	.87
Hawaii	NA	.33
United States	1.89	.74

[a]Estimates for 1975 based on homes with FHA insured mortgages.

[b]Estimates for 1976 based on taxes levied on land and buildings.

Note: These are state-wide average figures. Because of the difficulty of securing accurate and uniform data on assessment levels, these estimates should be interpreted as indicators of approximate difference in average tax rates. Consult sources for information on definitions and estimating procedures.

Sources: Estimates for owner-occupied single-family homes are from Advisory Commission on Intergovernmental Relations. *Significant Features of Fiscal Federalism: 1976-77 Edition*. Vol. 2, *Revenue and Debt*, 1977, p. 107.

Estimates for farm real estate are from Mary L. Bailey, *Farm Real Estate Taxes: 1976*, U.S. Department of Agriculture, RET-17, December 1977, pp. 16-17.

Property Tax Administration

The property tax system of each state differs, but the administration of the property tax involves a series of steps generally common to all states. These steps include: (1) assessment and classification of properties, (2) review of assessments, (3) equalization of assessments between assessment districts, (4) procedures for appeal of individual assessments, (5) determination of the property tax levy, and (6) collection of the tax.[3]

PROPERTY ASSESSMENT AND CLASSIFICATION

The first step in the taxation of property is to locate and record all taxable property, classify each property according to type, and determine the value of each property for tax purposes. In all but three states most taxable property is assessed by officials who are either elected or appointed as local property tax assessors. Local tax assessors are elected to office in about half the states. In about a fourth of the states, all local assessors are appointed to office. In the remaining states, local assessors may be either appointed or elected at the option of the local assessment district. Some states exer-

[3]**For a discussion of improving property tax assessment and equalization, see Chapter 3.**

Evaluating the Property Tax

Taxes are rarely popular, especially among those who pay them. Reaction to the property tax has been so irate at times that some observers have felt that a genuine taxpayers' revolt was imminent. Criticism of the property tax has a long history. In a classic study of property taxation published in 1931, Professor Jens Jensen commented:

"If any tax could have been eliminated by adverse criticism the property tax should have been eliminated long ago. It is even difficult to find anyone who has given it careful study who can subsequently speak of its failure in temperate language."[5]

Is the property tax a "fair tax"? Does the property tax system contribute to a "good tax structure"? Answers to these questions depend on what individuals believe to be true about property taxation and the extent to which these beliefs conform to their ideas about how things should be. Individuals may differ both in their ideas about the incidence and effects of the property tax and in their ideas about what constitutes a fair tax and good tax system. It is hardly surprising to find differences of opinion about what is wrong with the property tax and how it might be improved.

EQUITY

Politically acceptable taxes must be consistent with prevailing notions of fair play. Probably the most important question concerning the property tax is whether it leads to everyone paying his or her "fair share" of the tax burden. Everyone agrees that taxes ought to be equitable, but there is little agreement about what constitutes equity. Equity is a matter of personal philosophy rather than of technical economics.

There are two main approaches to the question of equity in taxation. One is the idea that taxes ought to be related to ability to pay. The other is that taxes ought to be related to the benefits which each taxpayer receives from public services. Neither approach is very satisfactory, and both are difficult to apply. Use of the ability-to-pay principle requires agreement on what best measures ability to pay (net wealth, current income, or spending). Application of the benefit principle requires that the public service benefits received by each taxpayer be known and measurable.

At one time property ownership may have been a tolerable measure of ability to pay, although even this may be disputed. It now is generally agreed that the ownership of property that is subject to taxation is a poor measure of ability to pay and that, when measured against current family income, the tax on residential housing is especially harsh on low-income families.

Property taxes are probably more closely associated with benefits received than ability to pay, especially when property tax revenue is used to finance public services which increase property values (fire and police protection, streets and roads, water and sewer facilities, etc.). However, the taxes levied against a particular property may not correspond very closely with the extent to which it is benefited. Moreover, a substantial share of property tax revenue is used to finance services principally benefiting people, not property (schools, public assistance programs, etc.).

Whether tax equity is viewed in terms of ability to pay or benefits received, the property tax cannot be rated very high. This is a major reason for public pressure to modify and de-emphasize the property tax as a source of government revenue.

NEUTRALITY

Most people seem to feel that taxes should not interfere with, or distort, the private economic decisions of households or businesses. However, the public may decide that tax policy is an appropriate means for correcting inefficiencies in the economy or achieving socially desirable changes in the behavior of individuals or businesses.

Property taxes may influence the economic decisions of households and businesses in several ways. To analyze the effects of taxes on real property, it is necessary to distinguish between taxes on land and taxes on capital improvements. Since the supply of land is virtually fixed, a tax on land can have no appreciable effect on the supply of land. A land tax will be borne by landowners, whose after-tax income will be reduced by the amount of the tax; and the tax will be capitalized into lower land values. If land is being put to its most profitable use, a land tax will not affect decisions about land use. The most profitable use of land without a land tax will still be its most profitable use with the tax. Thus, an increase in taxes on agricultural land would not be expected to change the way in which farmland is used, but it would reduce the after-tax income of the owners of agricultural land.

An increase in land taxes may affect land use in areas where land is not being used in the most profitable manner. Increased taxes on residential property on the fringe of expanding commercial-industrial areas may encourage more intensive land use. Farmland with value for potential subdivision development may be pressured into residential use if taxed according to its actual market value rather than its value for agricultural purposes. Increased land taxes make the speculative holding of land more expensive.

A tax on capital improvements has a much different effect. Unlike land, the volume of capital improvements, at least in the long run, is not fixed. Initially, an increase in taxes on capital improvements will reduce after-tax returns to owners. This will cause some investors to divert capital to other uses and eventually lead to a lower supply (and, therefore, higher price) than would have occurred without the tax increase. When this line of reasoning is applied to the housing market, increases in taxes on residential structures may be viewed as responsible for curtailing the supply of housing and increasing housing costs. This effect is probably

[5]**Jens P. Jensen,** *Property Taxation in the United States,* **p. 478.**

most severe in the case of low-income housing where the offsetting advantages granted homeowners by federal and state income tax provisions are less important.

Since the level of property taxes in different localities may vary substantially, property taxes may affect the locational decisions of households and businesses. Higher property taxes within central cities may provide an incentive for both households and businesses to move to suburbs where property taxes may be lower. When business inventories are taxed, firms may seek low-tax locations for warehouse facilities. Families may flee to suburban communities where they may be able to obtain both lower taxes and better public service of the kind they most want (schools, recreational facilities, police protection, etc.).

The importance of property taxes in affecting locational decisions should not be over-emphasized, however. Many factors other than taxes influence where people choose to live and where firms decide to locate. Moreover, the disincentive of higher taxes may be offset by the higher quality of public services provided by high-tax localities.

ADEQUACY, RELIABILITY, AND GROWTH

Most people would agree that a good tax system should provide an adequate and reliable amount of public revenue. This is especially important to state and local governments, which usually have limited authority to borrow when confronted with an unanticipated shortfall in tax collections. The property tax generally has been an adequate and dependable source of tax revenue for local governments. Unlike many other taxes, especially income taxes, property tax collections do not fluctuate as economic conditions change. Except in times of severe economic depression, when tax delinquency may increase, property tax rates can be adjusted to obtain the desired level of tax receipts. Over time, economic growth will lead to an increase in the property tax base.

Some argue that the adverse effects of the property tax are so serious that it should be used less or not at all as a source of local revenue. Some communities may face an imbalance between the property tax base and their tax revenue requirements. The mismatch between tax base and revenue needs can be substantial. Poor taxing districts may be unable to finance basic public services, even with high tax rates, which wealthy districts can easily provide with much lower tax rates.

The property tax can continue to provide most of the tax revenue for local governments in this country. Whether or not it should is another matter.

COLLECTION AND COMPLIANCE COSTS

Everyone is likely to believe that governmental costs for tax collection and compliance costs to taxpayers should be kept as low as reasonably possible. Verification of tax liability must be possible if the tax is to be enforceable, but the timing and method of tax payments and record keeping requirements should be convenient for the taxpayer.

Collection and compliance costs associated with property taxation compare favorably with other taxes. Particularly in the case of real estate, compliance costs (in terms of both time and money) are low. The fixed nature of real property virtually assures that the taxes levied will be collected. The cost of administering real estate taxes also is modest, but this may be partly because salaries paid tax assessors are low and programs of re-assessment and equalization are poorly funded. Measures to improve property tax administration almost certainly would increase collection costs. The taxation of personal property is administratively more difficult and is likely to involve both higher collection costs and higher compliance costs.

IMPARTIAL ADMINISTRATION

Fair and impartial tax administration can be most easily achieved if a tax is clearly understood by taxpayers and subject to little discretion on the part of tax collectors. An individual's tax liability should be specific and not subject to arbitrary judgment. Property tax administration is especially difficult because it is hard to achieve uniform assessment and equalization of property values for tax purposes. For this reason, the property tax is probably subject to more arbitrary judgment than any other major tax.

Most taxpayers have only a vague understanding of how their property taxes are determined or whether they are being treated fairly. Many of the property tax relief and reform measures adopted in recent years have tended to make property taxation more complicated and less understandable to the public. This illustrates one of the tradeoffs that may be required in designing a "good" tax system; in this case, what is believed to be an improvement in equity at the price of greater administrative complexity and cost.

THE NEED FOR COMPROMISE

Other criteria also may be used in evaluating an individual tax or a tax system. Any set of criteria is apt to involve conflicts that must be resolved. Attempts to achieve a more equitable tax system may increase collection and compliance costs; a tax system that provides an adequate and reliable amount of revenue may have certain adverse effects. It should be remembered that some of the undesirable effects of one tax may be at least partly offset by other taxes. Individuals may differ over the relative importance of various criteria.

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Chapter 3
ASSESSMENT AND EQUALIZATION

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Citizens expect good schools, well-maintained streets and highways, police and fire protection, and other local public services that contribute to their quality of life. The property tax is the major source of local revenue and, in some states, a significant source of state revenue. Administration of the property tax becomes increasingly important as costs of public services continue to rise.

More accurate assessment of property will help reduce inequities in the property tax system. The assessment and equalization process involves placing values on taxable properties and equalizing relative property values among local jurisdictions.

The assessment and equalization process involves three stages: (1) assessment of property by the assessor within a local jurisdiction and assessment review by a local board, (2) county equalization of assessment levels among local units, and (3) state equalization of assessments among counties. The first two stages may be combined in states with a county assessor system.

This chapter provides an overview of: (1) the need to improve the assessment of property within taxing units and the equalization of assessments among units; (2) different approaches to property appraisal; (3) the procedures for equalization; and (4) some possible ways to improve property tax administration.

The Problem

To assess property means to determine its official value for tax purposes. The value placed on property by the assessor becomes the tax base. The taxable value of property may be the market value estimated by the assessor or a specified percentage of the market value. Only the property tax has a base that is dependent on the opinions of individuals, in this case, the assessors.

Accurate valuation of properties, frequent re-assessment, and careful equalization of assessments are essential to good property tax administration. Many assessors do a very competent job of appraising properties and keeping assessments up to date. But, in too many cases, actual assessment practices do not conform to state laws, assessments are not uniform, and property valuations lag far behind actual market prices. The problems of property tax assessment have been described in this way:

"To find a value good and true
Here are three things for you to do
Consider your replacement cost
Determine value that is lost
Analyze your sales to see
What market value really should be
Now if these suggestions are not clear
Copy the figures you used last year."

VARIATION IN ASSESSMENT

Administration of the property tax calls for valuation of all taxable properties at market value. The assessed value of each property for tax purposes is based on market value. The goal of quality assessment is that all properties within an assessment unit be assessed at the same percentage of their market values. This percentage or ratio of assessed value to market value is usually referred to as the assessment ratio.

Taxpayers are subject to inequities in the distribution of the property tax load because of variations in the assessment ratio. Studies have indicated a wide variation in assessment ratios within and among assessment units. In general, there is a tendency to assess low-priced properties at higher assessment ratios than high-priced properties. The uniformity of assessment varies with the type of property. Nonfarm houses tend to be more uniformly assessed than farm properties and commercial properties. However, a 1971 study by the U.S. Census Bureau indicated that even among nonfarm houses, almost half the houses were assessed more than 20 percent too high or too low compared to the average for all homes. The study data indicated that in most North Central states, the variability of assessments exceeded the national average.

Factors contributing to lack of uniformity in assessments include difficulties in determining market value and lack of professionalism in the assessment process. Determining market value is difficult. Most properties are not being sold in a regular market such as the commodity market; properties are of different types and are unlike within types; and property values may fluctuate from one month or week to the next.

Most states have not professionalized the assessment process. Few states apply specific standards for qualification of local assessors or require special training. Qualifications of assessors range from highly trained, experienced, full-time appraisers to inexperienced individuals elected on the basis of popularity who work only part-time on assessments. States and counties differ in their progress toward well-trained assessors.

VARIATION IN ASSESSMENT LEVELS AMONG UNITS

A uniform level of assessment ratios among jurisdictions within counties and among counties in a state is an objective of a quality assessment program and is essential to reducing property tax inequities. Although most states have made considerable progress through equalization processes, a 1971 Census Bureau study indicated significant differences among states in inter-unit variation of assessment levels. The study indicated that in one of the North Central states, assessment levels in about half of the units were over 20 percent too high or too low compared to the state average. Among other states in the region this measure of inter-unit variation ranged from 17 percent to 5 percent of the state average assessment ratio.

Equalization of assessments among local units is necessary because governmental units may overlap assessment districts. For example, a large school district may overlap parts of several townships, parts of two or more counties, and a city. If properties in these different jurisdictions are assessed at different assessment ratios, tax burdens will be distributed unfairly.

Equalization of assessment ratios among taxing jurisdictions within a state becomes especially important under state-wide programs of state aid to local government. State equalization programs for public schools usually provide for more aid to school districts with a lower tax base per pupil. State-wide equalization of assessments is necessary for fair distribution of this type of state aid.

IMPACT ON TAXPAYERS

Lack of uniformity in assessments can cause serious tax inequities among property owners within an assessment district and among those in different districts. Although county and state equalization programs have reduced variation in assessment ratios among local units, this equalization process does not correct errors made by local assessors. The individual property owner will continue to pay too much or too little taxes so long as errors are made in the local assessment process. Improved property tax administration thus depends on improved assessment procedures.

The Appraisal/ Assessment Process

Market value is the common denominator in property tax assessment. The goal of the assessor is to determine the market value of taxable property. One generally accepted definition of market value is: "Market value of property is generally regarded as the amount of money which a willing, knowledgeable buyer would, in practical circumstances, pay to a willing, knowledgeable seller to acquire property, in a transaction free of duress for either."

An appraisal is an opinion about the market value of a property. The quality of the appraisal is based on the integrity and competence of the assessor and the availability of pertinent information.

The appraisal plan of an assessor could include: (1) determining the highest and best use of the property, (2) making an inventory of required data, (3) selecting the method to be used to estimate market value, and (4) allocating his or her time and resources toward achieving a quality assessment.

Market value may be estimated on the basis of: (1) market data; (2) cost of property; and (3) property income.

MARKET DATA APPROACH

The market data, or sales comparison, approach involves comparing the property being assessed with similar properties that have been sold recently. The assessor must first decide whether the property lends itself to the market data approach. A source of data on market sales in the local area is essential.

This approach reflects the actions of the market place and what buyers and sellers think the property is worth. To a large degree, the market data approach is self-assessment with less reliance on subjective judgments and opinions of the appraiser. Taxpayers can understand the data. Limitations to the market data approach are: comparable sales may be difficult to find; there may be no active market for a particular property; in a fast moving market, sales prices may lag behind current conditions; and outside factors such as credit terms or income tax considerations may influence the sale prices.

COST APPROACH

The cost approach is based on the principle of substitution, which states "that the maximum value of a property tends to be set by the cost of acquisition of an equally desirable and valuable substitute property." It is also sometimes referred to as the summation approach, that is, the summation of the estimated land value and the depreciated cost (cost minus depreciation) of the building and other improvements.

This "cost comparison approach" serves as a foundation for uniformity in assessments. It can be adapted to mass appraisal projects if current cost and depreciation schedules are market oriented. Cost estimates involve two concepts—reproduction cost and replacement cost. Reproduction cost refers to the cost of producing an identical or nearly identical building or structure. Replacement cost refers to the cost of constructing a structure that is not identical but has the same utility. Replacement cost is used for old and obsolete type structures.

The cost approach is more applicable to special purpose properties which are infrequently traded in the market and may not be income oriented. It may be used when reliable sales and income data are not available. It may also apply to newly constructed properties.

INCOME APPROACH

The income approach to determining market value is also referred to as capitalization of net income. The capitalization process estimates market value by converting annual income from ownership of the property into an expression of present worth. For example, a piece of property estimated to return an annual income of $10,000 and capitalized at an 8 percent rate would be worth $125,000 (V = I ÷ R or $125,000 = $10,000 ÷ .08).

The income approach may be applicable under several conditions: (1) when no reliable market data are available, (2) as a valid check against market data or cost approaches, (3) and as a guide to value to the buyer or seller. The income approach requires technical know-how in estimating net income and selection of capitalization methods and rates.

The income approach is usually used for assessment of real estate which normally is bought and sold on the basis of its income producing capability. This approach could include properties such as retail stores, shopping centers, office buildings, apartment houses, industrial buildings, and, in some cases, farmland.

DATA NEEDS

For any approach or combination of approaches to assessment, the assessor needs data to support his or her appraisal. General data include pertinent information on the community, the city, or the region. Social and economic trends can have a major influence on value. The local government and political atmosphere can affect value. The relationship of the property to its neighborhood is crucial.

More specific data would include information on building costs, land sales, property sales, rental rates and other market data. Soil productivity by soil types can be useful in appraising farmland. An assessment card for each property would include the title, description of the site, descriptions of improvements, and other pertinent data.

FINAL VALUE ESTIMATE

The assessor can use one or a combination of the appraisal approaches depending on the type of property and data available. The final step is estimating the value of the property. If a combination of approaches is used, the assessor will consider the amount and reliability of data used in each approach and the relevancy of the approach to the particular property being appraised. The most relevant approach should receive the most weight in the final estimate of market value. The assessed value is then calculated as a percentage of estimated market value, or the estimated value may be the assessed value.

The assessment process requires well-trained assessors who build a strong foundation of basic appraisal skills and pertinent data. Without this training and knowledge, the assessment can be little more than a guess. The final values determined by assessors affect the equity and uniformity of the property tax as a source of government revenue.

TYPES OF PROPERTY

The two major classifications of taxable property are real property and personal property. The three approaches to assessment previously discussed apply most directly to real property, which comprises the major share of taxable property. Basically, real estate includes land and improvements.

Railroads and public utilities are usually centrally assessed at the state level rather than at the local level because these properties usually overlap many local units of government.

Personal property that is taxed will vary from state to state. Some states have eliminated the personal property tax. "Taxation of Personal Property," chapter 5 in this publication, includes a discussion of the assessment of personal property.

Equalization of Assessments

A process of review and equalization provides for improving uniformity of assessments within and among assessment units. The review process involves checking the work of the assessor. Equalization involves adjustments among assessment jurisdictions or classes of property. Individual states have statutes providing for a system of review and equalization. The general procedure is similar among states.

REVIEW OF ASSESSMENTS

Local government boards are usually responsible for review of assessments in the township, municipality, or county. Each board is to review and correct assessments made so that every property on the list appears at its correct value relative to other properties. Although this is the prescribed procedure, it usually does not work as well in practice. The local board is heavily dependent on the work of the assessor and tends to correct only the most obvious errors. If property owners within a jurisdiction feel their assessments are unfair, many states allow them to petition for reassessment.

TAXPAYER APPEAL PROCEDURE

States provide a system of appeal to property owners who feel they have received an incorrect assessment. Although each state has its own system, the North Dakota procedure is outlined here as an example.

A property owner in North Dakota not satisfied with the assessment of her or his property has two alternative courses of action: the "equalization route" or the "abatement route."

Under the "equalization route," the property owner appears before the local city or township board of review. This board has authority to make corrections in assessments. If the taxpayer is dissatisfied with the local board's action, he or she may appeal its decision to the Board of County Commissioners when such board is acting as the board of equalization. If still not satisfied, the taxpayer may appeal the case to the State Board of Equalization.

Under the "abatement route," the taxpayer requests that the taxes be reduced, or refunded if already paid. The abatement action is started with application to the Board of County Commissioners but with the local board's recommendation attached to the application. If not satisfied with action taken by the county board, the taxpayer may request a hearing before the State Tax Appeals Board or the State Tax Commissioner. If not satisfied at this level, he or she may appeal to the district court.

An effective review and appeal procedure available to taxpayers gives real impetus toward improving the assessment process.

EQUALIZATION PROCEDURE

Under state statutes, a procedure is provided for equalizing assessment ratios among jurisdictions within a county and within the state. Usually this involves two stages—county equalization and state equalization.

County Equalization

A board of equalization at the county level has the responsibility to equalize assessment ratios among all governmental units within the county. The board may adjust individual property assessments but its primary duty is to compare and adjust the totals of unit assessment rolls so that the total assessed value is the same percentage of estimated market value for all local units. This procedure for equalizing assessment ratios among government units within a county is more easily said than done. The board of equalization may be limited by inadequate or incomplete data on market sales and property values. Many counties do not have the professional assessment staff to facilitate the equalization process. Political and social pressures tend to make the status quo the safest road.

State Equalization

A board of equalization at the state level has the responsibility to equalize the assessment ratios among all counties in the state. It reviews the total assessed values in each county compared to estimated market values and attempts to equalize these assessment levels across the state. The amount of authority given to this state board varies among states.

Equalization of assessment ratios across the state is important for several reasons: (1) nearly all states grant state aid to school districts, usually based on some formula involving the property tax base; (2) many school districts and special districts include parts of more than one county, which requires uniform assessment ratios across county lines; and (3) uniform assessment ratios across the state are essential for an equitable impact of state statutes affecting local mill levies, such as minimum or maximum levies, allocated levies, voted levies, or charter requirements.

Legislation in most states has encouraged assessment equalization through authorization of sales ratio studies, provisions for county assessment ratio equalization, and provisions for improving assessments.

ECONOMIC IMPACT OF ASSESSMENT

Quality assessment is important not only because of its direct effect on the property owner's taxes, but also because of its effect on local government revenue and on property values.

Significant upward or downward adjustment of assessment levels within a taxing unit may affect local government revenue. Taxable value multiplied by the tax or mill rate equals tax revenue. Thus, local governing boards might adjust the tax rates so that total revenue remains unchanged. However, where statutory minimum or maximum tax rate limits affect local levies, a change in assessment levels could affect the revenue of local units of government.

The quality of assessments affects individual taxpayers in two ways. First, it determines whether the taxpayer is overpaying or underpaying his or her "share" of taxes. Second, the assessment level affects the value of the property. Underassessed property is benefited by an increase in its market value and overassessed property is reduced in value by the tax.

Potentials for Improving Assessment and Equalization

Most states have made considerable progress in recent years toward improving assessment and equalization of property values for tax purposes. However, the 1971 Bureau of the Census survey indicates that serious inequities continue within and among taxing jurisdictions. A 1973 report on a survey conducted by the U.S. Senate Subcommittee on Intergovernmental Relations indicated "that by and large, the states have not met their responsibilities for making property tax assessments fair, expert, and easily understood."

Improvement of assessment implies cooperative efforts by local governments and state government toward expediting programs which will upgrade the assessment and equalization process.

EFFECTIVE ASSESSING ORGANIZATION

Three general types of assessing organizations predominate in the United States: (1) the county assessor organization in which the initial responsibility rests with the county assessor—used in 31 states; (2) an organization with townships, municipalities, and the county functioning jointly providing for initial assessing responsibility by township and municipal assessors but with some guidance and supervision from the county; and (3) the township-municipal organization providing for initial assessing responsibility by township and municipal assessors under equalization guidelines from the state.

The most effective assessing organization for a state or county may depend on its economic base and population density. In its recommendations for assessment reform, the Advisory Commission on Intergovernmental Relations stated that the local assessment district should be large enough so it has resources to become an efficient assessing unit. Other studies have indicated an assessing unit should be large enough to support a full-time competent assessor and staff in order to provide quality assessment. A local office with these resources could assemble data needed for appraisal, maintain a systematic inventory of properties, keep property owners informed on assessment levels and assessment changes, and be responsive to individual appeals. State coordination and equalization are more easily facilitated through local units with full-time assessors.

STATE SUPERVISION AND COORDINATION

State government has a responsibility to develop policies for improved property tax administration and to help with necessary supervision and coordination. Most states have enacted various policies for improving local assessment and the equalization process.

State Assistance for Assessors

State governments are improving assessment by providing information and assistance to assessors. A majority of the states conduct assessment-sales ratio studies annually or on a continuing basis and provide the information to public officials. Other types of assistance for assessors provided by some states include assessors manuals, short courses for training assessors, standard assessment schedules, consultation services, and continuing releases of current helpful information.

In cooperation with the colleges of agriculture and the Soil Conservation Service, some states provide productivity indices of soil types by area to aid in assessing farmlands. The extent of these types of assistance to local assessors varies from state to state.

Upgrading Assessors

Quality assessment depends on well-trained, competent assessors. States are using various approaches to upgrade skills of local assessors.

The state can establish policies and incentives to bring professional standards to the assessor position. Authority by the state supervisory agency to establish professional qualifications for assessors and to certify assessors is being used effectively in some states. Requiring certification also encourages the shift from part-time to full-time assessors. Shifting the assessment from local units to the county level tends to improve uniformity of assessments because the responsibility rests with one person rather than many part-time local assessors operating independently.

The assessor position can be upgraded through policies to provide adequate salaries, special training, full-time positions, and continuing help from a state supervisory agency. Assessors are elected in about half the states. Some would say that this type of position would be better served if appointive. Whether elected or appointed, well-trained, competent assessors are essential to quality assessment.

Full Value Versus Fractional Assessment

Tax laws in most states specify that property should be assessed at its "full" market value or "usual selling price." However, fractional assessment, that is, assessing at some fraction of market value, has become so common that some states have changed their laws, and others with statutes that specify full value are administering assessment on a fractional basis. The assessment ratio nationwide for all types of realty averages about 33 percent. Among states, the average assessment ratio ranges from about 5 percent to 85 percent.

Fractional assessment does not cause problems in assessment. However, fractional assessment tends to play down the differences in assessment of individual properties, making inaccurate assessments less obvious to property owners. The equalization process may be complicated by fractional assessment because the level of assessment is measured not against 100 percent, but against the average of assessment ratios in other districts.

IMPROVING INDIVIDUAL ASSESSMENTS

Competent assessors are essential to improving uniformity of assessment of properties within districts. However, state and local governments can encourage quality assessment through various means. County and municipal officials could provide more information to taxpayers on assessment ratios and dispersion of individual assessments to encourage public support for a quality assessment program. State and local publication of assessment ratios by local units and by property classes would provide taxpayers a basis for evaluating the quality of assessments.

State and local governments need to provide an effective assessment review and appeal process readily available to the taxpayer which he can use to protect himself against inequitable assessment. Property owners need information from their local assessor on assessment ratios and on changes in assessment. These procedures will encourage high quality assessment.

Within districts, local pressures may inhibit local assessors from making needed adjustments. Group re-

view by property owners might help update assessments. Representatives from the township or district could review assessments and recommend adjustments. Their recommendations could be adjusted and legitimized by a "town hall" meeting of all property owners.

Quality assessment can pay for itself, not only in additional revenue, but also in an equitable sharing of the cost of local government and a feeling of fairness among property owners.

Responsibility for Improving Assessment

The assessment and equalization of taxable property values are functions of state and local government. If the citizens of a local unit of government see the need for improving their assessment procedures and practices, they should become active in bringing about change. The assessment and equalization processes in a county or state are not likely to be better than citizens demand.

Assessments are opinions of value; therefore, they will not be without variation. However, this chapter has suggested that assessment processes can continue to be improved. Effective property tax administration is important for public confidence in local government.

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Chapter 4

USE-VALUE ASSESSMENT OF FARM AND OPEN SPACE LAND

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Historically, farm and open space land has been appraised for tax purposes according to its current market value. Current market value is the price a well-informed buyer is willing to pay and a well-informed seller is willing to accept for a parcel of property, with neither party being under duress.

Actual market prices are an indicator of current market value. However, some sales may not be arms-length transactions or may reflect coercion on one side or the other. Thus, sale prices may not always be reliable indicators of current market value. During the Depression, for example, many forced sales occurred.

Property tax assessors are responsible for estimating the value of taxable property according to statutory provisions. Assessments are estimates of value that involve human judgment and are, therefore, subject to error and dispute. The goal of uniform assessment is, in reality, impossible to achieve fully. This automatically renders assessment procedures and practices controversial, arbitrary, and products of compromise.

How Should Land Be Assessed?

No scientific principle dictates that real estate must be appraised for tax purposes according to its current market value. States generally require that assessments be based on actual market value. However, most states now provide for use-value assessment of agricultural and open space land under certain conditions. Use-value assessment is assessment of real estate according to its value in its *current use* rather than its value in a *potential use*. Maryland adopted the first use-value assessment law for farmland in 1967, and other states soon followed.

Before urbanization, current market value was probably a reasonably accurate measure of the value of land for agricultural use. But rapid growth of metropolitan areas has caused farmland to be converted into housing developments, shopping centers, industrial parks, and recreational facilities. No end to this growth and development is in sight, at least for the near future. Urban sprawl has brought the issue of market-value assessment versus use-value assessment to the forefront. Use-value assessment of agricultural land has attracted more and more attention during the past 20 years.

It was no accident that this issue first developed on the rural-urban fringe. In such areas, current market value tends to reflect the potential non-agricultural use of farmland rather than its current use in agriculture. The closer farmland lies to an urban center, the larger the difference between its use value in agriculture and its current market value. Land on the rural-urban fringe, because of its potential value for urban development, may be pulled from agricultural production and open spaces. It will likely carry a tax bill higher than can be readily paid out of income earned from farming if it is assessed according to the current market value principle. In fact, the tax bill could become high enough to push the land from agricultural production and decrease open spaces near urban areas.

Use-value assessment has two purposes. The first is tax relief for those who own farm and other open space land. The second is to give government another means of guiding land use. Tax policy can be a valuable tool in designing a plan for the future use and development of our land resources. Use-value assessment laws can be used to encourage the preservation of open spaces around urban areas and to eliminate, or at least lessen, the property tax as a factor in converting land from agricultural production to other uses.

How should farm and open space land be valued for tax purposes? This is the central issue.

Two alternative solutions emerge: (1) assess farmland according to the current market value principle, making no distinction between farmland and other real property; or (2) establish some form of use-value assessment for farmland.

Under market-value assessment, farmland would be assessed according to its current market value, which

may be based on a use which has a higher potential than agriculture. Under use-value assessment, farmland would be assessed according to its value for agricultural production. Use-value assessment, also called differential assessment, may be of three general types: preferential assessment; deferred taxation; and restrictive agreements.

Preferential Assessment

Under the preferential assessment approach, land devoted to agricultural use is assessed on the basis of its value in that use, and market value reflecting potential uses such as a housing subdivision or shopping center is ignored. The valuation of preferentially assessed farmland on the rural-urban fringe would be more consistent with the valuation of similar farmland in strictly rural areas. In both the rural-urban fringe and strictly rural areas, a close relationship would exist between the appraised value of farmland for tax purposes and its earning capacity.

If a preferential assessment law succeeds in separating bona fide farmers from other users, it will remove the property tax as a threat to the continued use of land on the rural-urban fringe for agricultural production. However, separating the bona fide farmer from the other user is difficult and requires an arbitrary definition written into the statute or an arbitrary decision by the assessor.

When is land farmed and when is it idle? Is a 10-acre tract on the rural-urban fringe containing a barn and the subdivision contractor's two horses a farm? Must the land be farmed by the owner? Just what is the definition of a bona fide farmer? How many previous years must the land have been farmed to qualify for preferential assessment? These are some of the questions to be answered when preferential assessment laws are enacted.

Regardless of the answers to these questions, preferential assessment laws permit the farmer-landowner to pay taxes on the value for agricultural purposes but reap the benefits of windfall gains when the land is priced and sold according to its value for non-agricultural purposes. Speculators may succeed under preferential assessment laws in obtaining a farmland classification by conducting very minimal farming operations, thereby paying lower taxes while holding land for future development. If the purpose is to preserve open spaces, it is immaterial who owns the land. Strict zoning ordinances may be effective in controlling development and preserving open spaces. But preferential assessment laws, by themselves, generally will not be effective in preserving open spaces. Why? Because, under preferential assessment, landowners can develop or sell their land at their own discretion with no penalty.

Preferential assessment will prevent taxes from pushing land out of agricultural production. However, it will not eliminate potential development values from pulling land out of agricultural production and open spaces.

Deferred Taxation

Deferred taxation is preferential assessment plus provisions for recapturing lost tax revenue when farm or open space land is converted to non-farm uses.

Under the deferred taxation approach, the assessor determines two values for each parcel of land: (1) current use value in agriculture; and (2) value in the absence of deferred taxation. Its value in agricultural use serves as the basis for current taxes. Its value in the absence of deferred taxation is based on the market value in its "highest and best use." If and when the land is diverted from agricultural production to its highest and best use, the owner must pay a "roll-back tax" based on the difference between current use-value assessment and market-value assessment in absence of deferred taxation. Interest could also be charged on the deferred taxes.

An arbitrary roll-back period must be established. Should it be 2 years, 5 years, 10 years, or 20 years? The selection of the roll-back period will determine the relative effectiveness of deferred taxation in preserving farmland near the rural-urban fringe. The longer the roll-back period, the more lost revenue will be recaptured and the more disincentive there will be to convert farm and open space land to urban uses.

Under deferred taxation, property taxes will no longer push land out of agricultural production. The roll-back may even slow down development until the increase in value is great enough to overcome the penalty for changing use.

Restrictive Agreements

A landowner and his local government may arrive at a formal agreement (contract) which prohibits the use of the land for non-agricultural purposes for a specified time period. In return the landowner is granted preferential assessment and pays taxes accordingly. The length of the time period is arbitrary.

Restrictive agreements are compatible with the ad valorem principle—taxation according to value in the highest legal use. The highest legal use would be agricultural production and, therefore, current use value and market value would be similar at the beginning of the contract period. Restrictive agreements would lessen any non-agricultural value at the beginning of the contract period. However, as the end of the contract period approaches, market value will increasingly reflect the potential use of the land for development after the contract expires. The landowner, under this approach, receives the benefits from preferential assessment but is denied any windfall gains he might receive from selling for non-agricultural use while the contract is in effect.

Restrictive agreements grant local government more land use control than either preferential assessment or deferred taxation. If land meets the minimum requirements under preferential assessment or deferred taxation laws and the owner chooses to use the provisions, local government usually must comply

whether or not it prefers an agricultural use for that particular tract. However, under the restrictive agreement approach, both the landowner and the local government must agree that the land is to remain in agricultural production or open space for a specified period of time.

Restrictive agreements will prevent property taxes from pushing land out of agricultural production and prevent the development of farm and open space land on the rural-urban fringe, at least for the length of the contract.

Determining Use-Value

If a differential assessment law is enacted, how can the use value of eligible land be determined? Three interrelated indicators of the use value of farmland are sales of farmland for agricultural purposes, income capitalization, and productivity.

Using agricultural sales to determine the use value of farmland requires that sales of farmland for agricultural purposes be separated from sales of farmland for other purposes. No foolproof way of separating the two exists. Today, land in remote rural areas that does not have a higher potential use than agriculture is being sold for prices much higher than returns from agriculture warrant. Recently, land prices have been rising due to investment demand. Most Americans think inflation is here to stay, so farmland is purchased as a hedge against inflation. Farmers and ranchers often bid up land prices to purchase tracts for expansion of their operating units. Consequently, it is impossible to determine accurately the use value of farmland from actual sales data of land sold for agricultural purposes.

Another way of determining the use value of farmland is the capitalization method. This method assumes that the net income derived from a parcel of land represents a certain rate of return to the value of the property. The value of the property is equal to net income divided by the capitalization rate. For example, a net income of $100 per acre capitalized at 5 percent indicates a value of $2,000 per acre ($100 ÷ .05 = $2,000).

The difficulty with this method is selecting an appropriate capitalization rate. A return of $100 per acre indicates a value of $2,000 per acre when capitalized at 5 percent but only $1,000 per acre when capitalized at a rate of 10 percent. The choice of a capitalization rate is somewhat arbitrary.

Use of the capitalization method requires statutory authority stipulating that the value of agricultural land shall be determined by the earnings of such lands during a certain period of time and capitalized at a selected rate.

Productivity of farmland can be estimated from soil survey maps or crop yields. The Agricultural Stabilization and Conservation Service has estimated projected crop yields for farm program payments. Other sources of information may also be available. In essence, the income capitalization method and the determination of productivity from crop yields taxes the farmer's managerial ability and therefore penalizes efficiency. The efficient farmer with higher yields and a higher net income will receive a higher assessment than the farmer with low yields and low net income. Unless we wish to penalize efficiency, the return to management accounted for in calculating net income must vary according to the farmer's managerial ability. Using differential assessment in place of the current market value principle will partially convert the property tax on farmland from a tax on accumulated wealth to a tax on income.

Determination of productivity from soil surveys avoids the taxation of managerial ability, but such surveys are expensive. Many counties throughout the United States either have never been surveyed or have surveys that date back to the 1920's. Moreover, even good estimates of the physical productivity of farmland do not resolve the question of how those estimates should be translated into a dollar measure of use value.

Constitutional Issue

Constitutional revision has been a necessary first step in the adoption of differential assessment laws in many states. State constitutions normally contain language mandating uniform and equal assessment and taxation. Consequently, a constitutional issue may emerge if we wish to assess farmland for tax purposes differently from the way we assess other forms of real property. In most states, a constitutional amendment must pass both houses of the legislature and be approved by the electorate. The only other way to resolve the constitutional issues is to pass a differential assessment law and test it in the courts.

What States Have Done

More than 40 states now have some type of differential assessment provisions for farm and open space land. Only a few states tax all real property on the basis of current market value; and, in most of these states, differential assessment bills have been introduced into the legislature at one time or another.

States have adopted differential assessment laws for the primary purpose of guiding land use and preserving agricultural land. This broad objective is highlighted in the Maryland law, which declares it to be in the general public interest that farming be fostered and encouraged: (1) to maintain a readily available source of food and dairy products close to the metropolitan areas of the state; (2) to encourage the preservation of open space as an amenity necessary to human welfare and happiness; and (3) to prevent the forced conversion of such open space to more intensive uses as a result of economic pressures caused by the assessment of land at a level incompatible with the practical use of such land for farming.

Differential assessment laws vary from state to state (table 13). Some of the distinguishable differences in the individual state laws center around provisions such as: size of eligible tracts; prior use requirements; pro-

Table 13. Use-Value Assessment Provisions for Agricultural and Open Space Land, 1976 and Subsequent Years

State	Provisions
Alabama	None.
Alaska	Deferred Taxation.
Arizona	None.
Arkansas	Use-value assessment only.
California	Use-value assessment only, and contracts and agreements. Basis for "full-value" of owner-occupied land zoned and exclusively used for single-family residential or agricultural purposes; and for parcels of 10 or more acres each, used for 2 or more years for nonprofit golf course purposes (value of any mines or minerals involved is added). Effective January 1, 1977, assessor must also consider any applicable restrictions in certified local coastal programs. Basis for "full-value" of open space land subject to specified restrictions and uses.
Colorado	Use-value assessment only. Use value based on productive capacity during reasonable period, capitalized at 11.5 percent, effective 1976.
Connecticut	Use-value assessment only (but sometimes classified as deferred taxation because of conveyance tax). Farm and forest open space land sold within 10 years of initial acquisition subject to conveyance tax ranging from 10 percent of sales price if sold in first year to 1 percent if sold in tenth year. Forest land, 25-acre minimum.
Delaware	Use-value assessment only. Not less than 5 acres, and use must be successive for 2 previous years.
Florida	Use-value assessment only; contracts and agreements. A sales price three or more times an agricultural use-value assessment creates a presumption that it is not used primarily for bona fide agricultural purposes.
Georgia	None.
Hawaii	Deferred taxation; contracts and agreements. Affects land dedicated to residential use. Expanded application approved June 1, 1976. Other agreements for other realty.
Idaho	None.
Illinois	Deferred taxation. Where applicable, subject to a minimum of 2 preceding years in benefited use, effective 1977.
Indiana	Use-value assessment only.
Iowa	Deferred taxation. Productivity and net earning capacity constitutes valuation basis, as revised 1977.
Kansas	Deferred taxation. Constitutional change (Art. 11, Sec. 12) approved November 2, 1976, authorizes legislature to prescribe assessment of "agricultural use" land on basis of actual or potential agricultural income or productivity.
Kentucky	Deferred taxation. Subject to gross income received in 3 of 5 preceding years. Amended 1976.
Louisiana	Use-value assessment only; contracts and agreements. Ten percent of use value, effective January 1, 1978. Agreements refer to reforestation contracts.
Maine	Deferred taxation. Amended October 24, 1977. A tree growth tax, amended February 9, 1978, provides for productivity based assessment, at specified levels, for forest land.
Maryland	Deferred taxation; contracts and agreements. Easements to a government or to The Nature Conservancy mean valuation which reflects the limitation on use.
Massachusetts	Deferred taxation. Agricultural land, 5-acre minimum. At least 2 preceding years in benefited use. Forest lands as specified.
Michigan	Contracts and agreements. Ten-year agreements. State financed; also related to household income (circuit-breaker type) effective 1974. Revised April 12, 1976.
Minnesota	Deferred taxation. Ten-acre minimum. Other provisions for land devoted to golf or ski purposes.
Mississippi	None.
Missouri	Use-value assessment only. Effective September 28, 1975, available to agricultural or horticultural land in such use for 5 preceding years, with average annual gross sales of $2,500.
Montana	Deferred taxation. Must meet specified conditions regarding income and size.
Nebraska	Deferred taxation. If eligibility ends, deferred tax paid on any difference in values for 5 years plus interest at 6 percent.
Nevada	Deferred taxation. Applies to agricultural and open space land, effective 1975, as amended, 1977.
New Hampshire	Deferred taxation; contracts and agreements. Effective 1973. Open space land redefined, 1976.
New Jersey	Deferred taxation.
New Mexico	Use-value assessment only. Based on productive capacity.
New York	Deferred taxation; contracts and agreements. Applies to agricultural and forest land. Minimum size specified for each.
North Carolina	Deferred taxation. Applies to parcels of 10 acres or more, with gross income from products grown averaging $1,000 or more annually for 3 preceding years.
North Dakota	Use-value assessment only. Land classified as agricultural prior to annexation retained in that classification until use changes. Value must be uniform with that of adjoining agricultural land not annexed.
Ohio	Deferred taxation on a partial basis. Specified minimum size; agricultural use 3 preceding years minimum.
Oklahoma	Use-value assessment only.
Oregon	Use-value assessment only; deferred taxation. Deferred taxation does not apply if the specified use is the zoned use.
Pennsylvania	Contracts and agreements. Specified term agreements, farm or forest land, 10 acres or more, in benefited use 3 preceding years, anticipated annual gross income of $2,000.
Rhode Island	Deferred taxation. Farm, forest, or open space land.
South Carolina	Deferred taxation. Applied to certain agricultural land.
South Dakota	Use-value assessment only.
Tennessee	Deferred taxation. Agricultural or forest land, 25-acre minimum. Open space land, 3-acre minimum. Effective January 1, 1977.
Texas	Deferred taxation. Income capitalization may also be used. Effective January 1, 1978.
Utah	Deferred taxation. Five-acre minimum waived if owner received 80 percent or more of income

Table 13. continued

State	Provisions
	from agricultural products on 5 contiguous acres.
Vermont	Deferred taxation; contracts and agreements. Amended 1978.
Virginia	Deferred taxation. Specified use assessments result from exercise of local option by local governments.
Washington	Deferred taxation; contracts and agreements.
West Virginia	None.
Wisconsin	Constitutional amendment, approved April 2, 1974: Taxation of agricultural and undeveloped land need not be uniform with that of each other or other realty. Effective May 18, 1978, income tax credits and refunds available to eligible owners of qualifying farmland of 35 acres or more. Applies to specifically defined "excessive property taxes;" maximum of excessive amount is $6,000.
Wyoming	Use-value assessment only. Minimum of 2 previous years in benefited use.

Note: Deferred taxation means that change from explicitly defined benefited use activates tax on value differences for specified time periods, plus any interest specified.

Contracts and agreements mean agreements providing for limitations on use over specified time periods as part of explicitly specified use-value assessment.

Source: U.S. Bureau of the Census, *Census of Governments: 1977*, GC 77 (2), Vol. 2, *Taxable Property Values and Assessment/Sales Price Ratios*, November 1978, pp. 286-287.

ductivity requirements; permitted uses; systems for determining use value; roll-back provisions; and terms of classification.

Differential assessment laws generally apply to land devoted to agricultural uses, although definitions of agricultural use vary. In some states, forest land and other open space land is also eligible. A number of states have special provisions for land devoted to recreational uses (golf courses, ski areas, etc.).

Most states attempt to restrict eligibility for use-value assessment to "bona fide" farmers by requiring that applicants must have been engaged in farming for a specified number of years or that a certain percentage of the owner's income must be derived from farming. Income per acre is also used as an eligibility factor in some states.

Some states have no minimum size provisions to qualify for differential assessment. Those that do usually require five to ten acres.

Some differential assessment laws make no mention of the procedures and guidelines assessors are to use in determining use value, while others establish lengthy and specific assessment provisions. The value of agricultural land is often determined on the basis of productivity, using soil survey data. Some state laws specify the rate at which earning capacity is to be capitalized.

Deferred taxation laws include a roll-back provision. The roll-back payment is equal to the difference between the taxes that would have been paid in the absence of differential assessment and the taxes that were actually paid. The roll-back payment is usually due when the land is converted to non-agricultural uses. Some states require that interest be paid on the taxes that were deferred. The roll-back period varies from state to state, generally ranging from two to ten years. States that have restrictive agreement laws usually require a minimum agreement term of ten years.

Concluding Comments

Differential assessment will lower taxes on land that has a use value which is lower than its current market value. The reduction will be greater on the rural-urban fringe than in rural areas where farming is the highest and best use for most land.

A community's tax base will be reduced as a result of differential assessment. The cost of the benefits that accrue to eligible property owners is usually borne by other residents in the form of increased property taxes. However, local governments may attempt to replace lost property tax revenue by enacting local sales or income taxes or by seeking additional state aid. Local governments also might try to operate with smaller budgets.

Differential assessment can be used as a land use policy tool to help preserve open spaces on the rural-urban fringe and neutralize the property tax as a factor in converting land from agricultural production to other uses. The specific provisions of the law will determine its success as a land use policy tool. Restrictive agreements are apt to be more effective in this respect than deferred taxation. Differential assessment, by itself, may act to encourage urban sprawl and leapfrog development.

Land is removed from agricultural production and open spaces partly because it is pushed out by rising taxes and partly because it is pulled out by attractive development values. Differential assessment laws may reduce the push but, at best, have only a minimal effect on the pull.

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Chapter 5

TAXATION OF PERSONAL PROPERTY

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For tax purposes, personal property consists of privately owned tangible and intangible personal property used in business or for consumption. Tangible personal property includes such items as business inventories; machinery and equipment; livestock; grain, seed and hay; motor vehicles; and household goods and personal effects. Intangible personalty includes money, bank deposits, stocks, bonds, mortgages, franchises, patents, and other assets which have value for what they represent.

Historical Background

Taxes have been levied on personal property for many centuries—in ancient Egypt, Greece and Rome, through the Middle Ages and on to the present time. In this country personal property has been taxed by state and local governments since the colonial period. The personal property tax is now used mainly in the United States, having been dropped by most other countries as a source of governmental revenue.

Before the Industrial Revolution, livestock was the principal component of the personal property tax base. With the growth of industry, commerce, and personal fortunes, the tax base expanded to include machinery, equipment, furniture, and fixtures used in manufacturing and trade; and household furnishings, personal effects, and intangible personalty. The importance of this tax as a source of revenue increased through the nineteenth century and stabilized until the Great Depression. Since then, its role in state and local tax structures has diminished as administrative problems and political pressures led to partial or total exemption of personal property with replacement revenue coming from sales and income taxes and grants-in-aid from state and federal governments.

The personal property tax has been controversial throughout its history. Criticism intensified early in the nineteenth century with the inclusion of business personalty. In 1819, Governor Oliver Wolcott of Connecticut called it "ill-adapted to our needs and detrimental to our growth." It has been condemned for failure to meet such important objectives of government revenue policy as adequacy, flexibility, equity, efficiency, convenience, certainty, and neutrality. It persists because of the revenue it provides to state and local governments still using it, and the political problems involved in obtaining replacement revenue.

The trend toward exemption of personal property from the property tax base—first, household goods; then intangibles; finally business personalty—is a recognition of public finance reality. State legislatures are realizing that administrative and enforcement problems of taxing personal property are very difficult, often insoluble, and that alternative sources of revenue can provide the needed funds more efficiently and equitably.

Taxable Status of Personal Property

In 1976, the latest year for which information is available, tangible personal property was completely exempt from local property taxation in four states—Delaware, Hawaii, New York, and Pennsylvania. Partial exemption was provided in 38 states and the District of Columbia. General coverage remained only in Arkansas. Table 14 summarizes the property tax status of four major classes of tangible personal property but does not specify partial exemptions within these classes.

Intangible personal property was totally exempt from local property taxation in 36 states and the District of Columbia. Partial exemption was the rule in the other 14 states. Special state property taxes were levied on certain types of intangibles in a number of states.

Table 14. Legal Status of Major Types of Tangible Personal Property With Respect to Local General Property Taxation, by States: 1976

State	Commercial and industrial	Agricultural	Household personal	Motor vehicles	State	Commercial and industrial	Agricultural	Household personal	Motor vehicles
Number of taxing states	47	42	26	21	Missouri	T	T	E	E
					Montana	T	[1]T	E	[1]T
Alabama	[1]T	[1]T	[1]T	T	Nebraska	[1]T	[1]T	E	T
Alaska	L	L	[1]L	L	Nevada	T	T	T	E
Arizona	[1]T	T	E	E	New Hampshire	T	T	E	E
Arkansas	T	T	T	T					
California	[1]T	[1]T	[1]T	E	New Jersey	[1]T	T	E	E
					New Mexico	[1]T	[1]T	[1]T	E
Colorado	T	T	[1]T	E	New York	E	E	E	E
Connecticut	[1]T	[1]T	E	T	North Carolina	[1]T	[1]T	[1]T	[1]T
Delaware	E	E	E	E	North Dakota	[1]T	[1]T	E	[1]T
District of Columbia	[1]T	E	E	E					
Florida	T	T	E	E	Ohio	T	T	E	E
					Oklahoma	T	T	[1]T	E
Georgia	T	T	[1]T	T	Oregon	[1]T	[1]T	[1]T	E
Hawaii	E	E	E	E	Pennsylvania	E	E	E	E
Idaho	[1]T	T	[1]T	E	Rhode Island	[1]T	T	[1]T	T
Illinois	T	T	E	[1]T					
Indiana	T	T	[1]T	E	South Carolina	[1]T	[1]T	E	T
					South Dakota	T	T	T	[1]T
Iowa	[1]T	[1]T	E	E	Tennessee	[1]T	[1]T	[1]T	T
Kansas	T	T	[1]T	T	Texas	T	T	[1]T	T
Kentucky	[1]T	E	E	T	Utah	[1]T	[1]T	E	T
Louisiana	T	E	[1]T	E					
Maine	[1]T	[1]T	E	E	Vermont	T	[1]T	E	E
					Virginia	T	T	L	T
Maryland	[1]T	[1]T	[1]L	E	Washington	[1]T	[1]T	E	E
Massachusetts	T	T	E	E	West Virginia	T	T	[1]T	T
Michigan	T	E	[1]T	E	Wisconsin	[1]T	[1]T	E	E
Minnesota	[1]T	[1]T	[1]L	E	Wyoming	T	T	[1]T	E
Mississippi	T	E	[1]T	T					

Note: T locally taxable. E exemption. L local option; except in Virginia, option to exempt affected items is exercised in most jurisdictions. Information is not available on state taxation of tangible personal property because the amount of revenue from this source is currently very small.

[1]Subject to legal provisions for partial exemptions.

Source: *Assessed Valuation for Local General Property Taxation, Preliminary Report No. 2*, GC77(P)-2, 1977 Census of Governments, Bureau of the Census, U.S. Department of Commerce, Washington, D.C. 20233, November, 1977.

Problems in Personal Property Taxation

ADMINISTRATIVE PROBLEMS

Obtaining a complete listing of taxable personal property is nearly impossible for any assessing district. In contrast with land and permanent improvements, personal property is movable and some types, especially intangibles, can be easily concealed.

Business inventories fluctuate during the year and can often be reduced to low levels before assessment dates. Modern business and industry, including agriculture, use a wide variety of machines and equipment in their operations. The number of livestock on a farm or ranch is difficult to verify. Livestock born or received and marketed between assessment dates is usually not taxed. Nearly complete listing is achieved with motor vehicles which must be licensed. The poorest record typically has been with intangibles and personal effects such as jewelry, cameras, guns, and art objects.

Local assessors are often inadequately trained and vulnerable to political pressures. A conscientious assessor may not survive the next election. Strict enforcement is expensive and unpopular. Self-assessment penalizes honest taxpayers.

Determining value of personal property for tax purposes is the second major administrative problem. The economic definition of the value of an item is its power in exchange. This market value of an item is its power in exchange. This market-value rule is included in most property tax statutes and works fairly well for items which have determinable market values like motor vehicles, farm machinery, livestock, and grains.

But the market-value rule is difficult to apply to many types of business personalty not regularly bought and sold. What is the value of a physician's five-year-old x-ray machine? A newspaper's ten-year-old printing press? Franchises, patents, and goodwill can be considered forms of wealth. How can assessed values be placed on such intangible assets? Or upon professional degrees and licenses to practice which represent earning capacity to the holders?

Inventory valuation is related to the listing problem. Should inventory value be that existing on one assessment day during the year or should a 12-month average be used?

Taxation of intangibles on the same basis as tangible personalty may so reduce the return on investments that capital will flee to low- or no-tax areas. This policy also creates a strong incentive to evade the tax by underreporting and concealment. The history of intangible property taxation is a chronicle of high administrative costs, sporadic enforcement campaigns, and legislation for special treatment and exemption. Public finance experts have called this tax the least important, least secure, and least respectable of the property tax family.

Specific definitions and clear-cut guidelines are lacking for determining the taxable value of many kinds of personal property. Wide latitude for human judgment and abundant opportunities for human error thus characterize listing and valuation of personal property for tax purposes.

MEETING OBJECTIVES OF REVENUE POLICY

Taxes available to state and local governments can be evaluated in terms of commonly accepted criteria or objectives of revenue policy. Citizens typically assign differing degrees of importance to these criteria according to their beliefs and personal financial circumstances. Tax policy goals of individuals sometimes coincide and sometimes conflict with those of government.

Adequacy and Flexibility

An adequate tax system yields enough revenue during a fiscal period to enable a governmental unit to meet its public service responsibilities. A flexible source of revenue can be adjusted according to changing governmental needs. The property tax in general can be an adequate and flexible source of revenue for most local governments except school districts. The personal property tax by itself is obviously not an adequate or flexible source of revenue. Real property value far overshadows that of personal property even in those areas where business personalty is still taxed. In an agricultural state like Nebraska, 75 percent of total property tax revenue comes from real estate. Personal property tax revenue is unstable and unpredictable because of changes in prices and business inventories.

Since the mid-thirties, personal property taxes have been providing a diminishing share of state and local government revenue. The tax base has been eroded by special treatment of certain classes of personal property. Sales and income taxes are now being used increasingly as sources of revenue in our industrialized society.

Equity

This objective is based on the belief that "everyone should pay his or her fair share of taxes." This implies that the cost of providing public services should be distributed among taxpayers according to ability to pay, benefits received, widespread participation, and impartial treatment.

Ownership of personal property is regarded by many people as an imperfect measure of ability to pay. Business firms engaged in agriculture, manufacturing, and wholesale and retail trade require large amounts of personal property. Some of these can reduce inventories before assessment time; others cannot. Many businesses and professions need very little personalty in earning substantial incomes; for example, real estate and insurance agencies, banks, lawyers, doctors, dentists, and teachers. Owners of personal property benefit directly from such public services as police and fire protection and enforcement of contracts as do owners of real estate.

Efforts to deal with administrative problems of personal property taxation represent departures from the principles of uniformity and universality in tax policy. Examples of differential treatment among personal property owners are: currency may be taxed, but U.S. government bonds exempt; taxation of state and local government bonds from other states, but exemption of those from the holder's own state; and exemption of real estate mortgages, but taxation of chattel mortgages on personal property. Taxation of intangibles is regarded by some people as double taxation because intangibles represent an interest in other property; however, such taxation has been upheld by the courts. The same argument could be applied to farm machinery subject to sales tax and property tax.

Exemption of certain classes of personal property or complete exemption shifts that portion of property taxes to non-exempt property, particularly real estate, unless replacement revenue comes from other sources. But exemption of personalty has occurred, and will be more widely adopted, because accurate assessment is impossible, inequity is inevitable, and revenue does not justify administration costs.

Efficiency, Convenience, and Certainty

These criteria relate to tax administration by government and tax planning and payment by citizens. Inherent administrative problems make the personal property tax inefficient. The cost of strict enforcement could conceivably exceed the additional revenue obtained. Lack of enforcement may cause disrespect for the entire property tax system.

Personal property taxes do not measure up well against the standards of convenience and certainty for either government or taxpayers. The tax base and revenue can vary widely from one year to the next. An example of this variation is changes in livestock production and prices in farming areas. The tax due dates may not coincide with receipt of taxpayers' income. Uncertainty may result from shifts in enforcement policy from laxity to strictness.

Compatibility of Objectives

According to this criterion of revenue policy, the tax system should contribute to, or at least interfere as little

as possible with, attaining other public policy goals—economic growth, distribution of income, and resource use.

Although long condemned for its effect upon the ability of a community to compete for business and industry, studies show that taxes on business personalty are rarely an important consideration in business location unless clearly out of line with alternative locations. State and local government officials worry more over the effect of taxes on business location than do those making location decisions.

Income distribution is affected by the tax system. Taxes on business personalty will be shifted forward to consumers, backward to suppliers, or partially to employees and stockholders depending upon the competitive situation. Businesses like agriculture made up of many small firms competing in national and world markets have little opportunity to shift a state or local tax. This inability to shift taxes not only reduces net business income but also represents differential treatment of businesses for tax purposes.

Enforcement vs. Exemption

The main policy choices for citizens and public officials regarding the personal property tax are:

1. Improved tax administration, including stricter enforcement of tax laws.
2. Partial or complete exemption and other special treatment of personal property.

IMPROVED TAX ADMINISTRATION

The personal property tax in some form seems likely to persist in the state and local tax structures of several states for two reasons: the revenue it provides; and the feeling that it is morally justified, particularly the tax on business personalty. Public finance experts generally agree that, when this tax is used, good administration and vigorous enforcement are essential to obtain the potential revenue and to prevent corruption of the entire tax system.

One method for improving tax administration is to institute continuing programs to educate citizens in public finance principles and the nature and operation of their state and local tax systems. Responsibility for this effort could be assumed by such impartial agencies as the Cooperative Extension Services of the land-grant universities. Citizens of a taxing district, whether local, state, or federal, could be provided with more understandable information from appropriate public officials on spending and revenue policies and practices.

Well-trained, specialized assessment personnel, less subject to political pressure, could be an important step to improved property tax administration. Appraisal specialists might be appointed under a merit system after meeting qualifications established by the state. Cities or urbanized counties might consider employment of specialists in evaluating business inventories, machines, and equipment. Valuation guides could be provided and kept up-to-date by state departments of revenue. Auditing assistance could be available to local government from the state.

Local assessors' offices should have access to modern techniques and equipment for data processing. Cost to non-urban, sparsely populated counties could be held down by sharing with other government units or by contractual arrangements with the state or other institutions leasing or owning electronic data processing equipment and having staff trained in its use.

In some states, legislation may be needed to strengthen state supervision of local property tax administration and to provide additional authority for enforcement to appropriate local government officials. Access to federal or state income tax returns for information on business inventories and capital gains would improve compliance because the state and local governments could ride "piggy-back" on the enforcement power of the federal government. Other possible procedures include automatic tax collection on bank deposits, and checking lists of stockholders and bondholders.

Self-assessment, or the honor system, of listing and valuing personal property, has been tried in some states to hold down administrative costs and reduce concealment and under-reporting of taxable items. This approach has been largely unsuccessful because it penalizes honesty and encourages taxpayers to report only enough property to get by without an audit while not being too far out of line with similar taxpayers. If this method is used, audit procedures should be developed to check samples of all personal property, not just easily checked classes.

Possible consequences of attempts to improve administration and more strictly enforce laws pertaining to personal property taxation are:

1. Greater expenditures for salaries, office machines or machine hire, for travel and subsistence while attending training schools, and for taking cases to court.
2. Increased taxpayer resistance to enforcement efforts and higher costs with possible political repercussions.
3. Continued lack of uniformity in treatment of different individual and business taxpayers.
4. Loss of tax revenue as personal property, especially investment capital, migrates to low- or no-tax areas.

EXEMPTION AND OTHER SPECIAL TREATMENT

States have turned increasingly to exemption and special treatment of personal property for tax purposes as they attempt to solve or avoid the difficult problems of listing and valuation. This trend has been encouraged by success in using state and local sales and income taxes for replacement revenue.

Exemption practices vary from complete exemption of tangible and intangible personalty from property taxes to exemption of only one or two classes. Some states exempt personal property from local taxes while

applying state taxes to certain classes, usually intangibles. Few states now attempt to tax household goods and personal effects not used for business purposes because cost of enforcement equals or exceeds revenue obtained. Ease of concealment and fear of an exodus of investment capital are mainly responsible for exemption of intangibles from local property taxes. Business personalty, including that of farmers, is still subject to local property taxes in most states but specified types are exempt in many cases. Complete or partial exemption of agricultural, commercial, and industrial personalty will probably expand in the future.

Special classification and low rates have been used by many states in an effort to get a higher percentage of intangible property on the taxrolls. Intangible property may be assessed at a lower percentage of actual value than tangible property, or a substantially lower tax rate may be applied to intangibles. This method has been successful in getting more intangibles listed, judging by experience in Nebraska and other states which have used it in the past. The current direction in state tax policy is to tax the income from intangibles rather than to tax them as property.

The possible consequences of special treatment for personal property are:

1. Loss of property tax revenues as the tax base is reduced and one exemption leads to successful efforts to exempt other classes of personal property.
2. Reduction in public services unless replacement revenue is provided by higher levies on property remaining on tax rolls, from states sales and income taxes, or by adoption of local sales and income taxes.
3. Lower costs for property tax administration which may in some instances exceed the loss in revenue.
4. Improved economic climate for investment in state and local commerce and industry.
5. Differential treatment among property owners and diminished respect for the tax system unless minimized through sales and income taxes.

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Chapter 6

POLICY ISSUES IN PROPERTY TAXATION

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Passage of Proposition 13 by California voters in June 1978 signaled renewed public concern with property taxation and the overall growth of state and local government spending. Proposition 13 amended the California constitution in a way that sharply reduced local property taxes, limits property tax levels in the future, and restricts the rate at which property assessments may be increased. A few states have passed similar amendments to their constitutions, and some states have approved overall state spending limits. Such proposals are likely to be considered in most states in the next few years.

Numerous complaints and criticisms have been lodged against the property tax over the years—along with countless suggestions about how property tax systems could be improved. Many states have acted in recent years to remedy some of the shortcomings of their property tax systems, but many issues concerning property taxation are yet to be resolved. Some of the principal issues are:

- Ways of improving property tax administration.
- Erosion of the tax base as a result of complete or partial exemption of certain property from taxation.
- Taxation of personal property.
- Wide disparities in tax base between taxing jurisdictions.
- Property tax relief measures.
- Possible repeal of the property tax.

Property Tax Administration

The Advisory Commission on Intergovernmental Relations (ACIR) has identified four key elements for improving state property tax systems:

1. *Legitimacy*—assessment practices should be legalized by either raising local assessment standards to the level required by law or by changing state law to validate current assessment practices.
2. *Openness*—all valuation information needed to enable the taxpayer to easily judge the fairness of his assessment should be sent to the taxpayer and a simple, informal appeal procedure should be established.
3. *Technical proficiency*—the assessor should have the ability and necessary equipment to make accurate market value estimates of all properties he is responsible for and he should be required to keep his assessment rolls current.
4. *Compassion*—tax relief for those taxpayers carrying extraordinary property tax burdens in relation to current income should be provided and financed by the state.[1]

If the property tax is to be retained, it is essential that it be administered in a fair and efficient manner. Much of the dissatisfaction with the property tax can be attributed to poor administration.

Accurate valuation of properties, frequent reassessment, and careful equalization of assessments are necessary to achieve better property tax administration. Many assessors do a very competent job of appraising properties and keeping assessments up to date. But, in many cases, actual assessment practices do not conform to state laws, assessments are not uniform, and property valuations lag far behind actual market prices.

In all but three states—Hawaii, Maryland, and Montana—most taxable property is assessed by local officials. Numerous suggestions have been offered concerning ways of increasing the technical proficiency of

[1] **Advisory Commission on Intergovernmental Relations,** *The Property Tax in a Changing Environment: Selected State Studies,* **Information Report M-83 (Washington: U.S. Government Printing Office, 1974), p. 3.**

assessors and achieving more uniform property assessment.[2] They include:

1. Consolidation of assessment districts to permit the employment of full-time, specialized property appraisers.
2. Appointment, rather than election, of qualified professional assessors.
3. Closer state supervision of the local assessment process.
4. State assessment of properties that are particularly difficult to assess.
5. Establishment of assessor training programs and state certification of local assessors.
6. Increased use of market sales data as a check on assessments.
7. Use of computers and other equipment for automatic data processing and record keeping.
8. More frequent re-assessment of properties.

Erosion of the Tax Base

Complete or partial exemption of certain classes of property from taxation reduces the property tax base available to local units of government. Property tax exemptions provide a subsidy to the owners of property that is given special tax treatment. Unless the state reimburses local governments for the potential revenue lost when new exemptions are created, the cost of property tax concessions will be borne by the owners of non-exempt property within each taxing district.

The exemption of federally-owned property is a long-standing controversy, especially in the western states where vast amounts of land are owned by the federal government and in localities where the presence of federal facilities has added substantially to demands for locally-financed public services. In certain cases, Congress has authorized payments to state or local governments to compensate for the tax immunity granted to federal property. These payments can be made in three ways:

1. Payments in lieu of taxes, based either on the value of the exempt property or the services provided to the property or the persons occupying the property.
2. Permitting state and local units to levy property taxes against some types of federal property.
3. Sharing revenues from federal property with state or local units.

Problems also occur because of exemptions granted to property owned by state and local governments and to certain classes of private property. Localities in which exempt property is concentrated may be compelled to provide public services to exempt properties that must be paid for by the owners of non-exempt properties within that taxing jurisdiction. In such cases, arrangements for payments in-lieu of property taxes merit consideration on grounds of equity. Who, for example, should pay the cost of fire, police, and other services provided to state-owned property—all of the residents of the state or only those who happen to live in its capital city? The answer to such a question is not clear-cut. The presence of certain types of tax exempt property may benefit a community far beyond the loss of potential tax revenue; other types of exempt property may simply add to the local property tax load with no offsetting benefits to the community.

Special provisions for taxation of certain classes of private property have mushroomed, especially property tax relief for homeowners and reduced or deferred taxation of farmland. In some cases, these provisions have narrowed the local property tax base and benefited certain property owners at the expense of others.

Who should pay for property tax relief? States may require, or make optional, certain types of property tax relief. Property tax relief may be financed by imposing higher taxes on local property owners who are not given preferential treatment, increasing other local taxes if they are available, or raising charges for local services. Alternatively, the cost of property tax relief may be paid on a state-wide basis through state reimbursement to local governments for any loss in property tax revenue or by direct credits or refunds to taxpayers.

Taxation of Personal Property

Should personal property be taxed? Most experts agree that, as long as we retain the property tax, there are good reasons for taxing major classes of tangible personal property but that intangibles require special treatment. A major justification for the taxation of personal property is based on equity considerations. Exemption of personal property, it is argued, would discriminate in favor of taxpayers who have relatively large amounts of personalty and impose higher taxes on the owners of non-exempt property. This problem might be partly overcome if replacement revenue from other sources is found.

Taxation of personal property poses two basic issues:

1. Should personal property be taxed? If so, how can the administration of the tax be improved?
2. If some or all classes of personal property are exempted from the property tax, should personal property be taxed in some other manner?

Fiscal Disparities

The assessed valuation available for local taxation varies widely from one taxing jurisdiction to another. The problem of fiscal disparities has been especially acute in the financing of public schools. In several states, the legality of the state's school finance system has been challenged on the grounds that it discriminates against school children and taxpayers in poor

[2] See chapter 3.

districts. In a landmark decision in August 1971, the California Supreme Court ruled in *Serrano v. Priest* that the California system of financing public schools was unconstitutional because "it makes the quality of a child's education a function of the wealth of his parents and neighbors." State courts have declared school finance systems unconstitutional in a number of other states.

A three-judge federal district court handed down a similar ruling in *San Antonio Independent School District v. Rodriguez*. The court held that the Texas school finance system violated the equal protection clause of the Fourteenth Amendment to the United States Constitution and declared that "the quality of public education may not be a function of wealth other than the wealth of the state as a whole." This ruling was overturned by the U.S. Supreme Court in 1973 in a five to four decision.

Failure of the U.S. Supreme Court to uphold the district court's ruling in the Rodriguez case does not foreclose challenges to school funding systems in state courts. Additional school finance litigation may be expected. Moreover, many state legislatures have been prodded into re-examining the relationship between educational expenditures and the property tax base of local school districts. The problem of gaps between available tax base and local revenue needs is also becoming evident in providing other kinds of public services.

A variety of proposals have been offered as solutions to the problem of fiscal disparities. They include:

1. Changing the distribution of state and federal aid to local governments to provide a larger share of available funds to units with a low property tax base and high expenditure requirements.
2. Increasing the amount of state and federal aid to local governments and school districts to reduce the reliance of local units on property tax revenue. By itself, this will not reduce relative disparities in tax base, but it will reduce the absolute size of such disparities.
3. Having the state government assume responsibility for providing certain public services that some localities are unable to finance adequately.
4. Encouraging, or requiring, the consolidation of governmental units so that differences in tax capacity can be reduced.
5. Providing for sharing of all or part of the property tax base between independent governmental units. Such a plan has been adopted in Minnesota, where 40 percent of the increase in taxable valuation of commercial and industrial property is to be shared by governmental units in the Minneapolis-St. Paul metropolitan area.

Property Tax Relief

Several proposals have been made to reduce taxes on certain classes of property and to de-emphasize or completely replace the local property tax. Every state now provides some type of property tax relief for the elderly, and more than half have extended property tax relief to all low-income homeowners and, in some states, renters. Most states provide special tax treatment for agricultural, timber, or open space land; and the trend toward reduced reliance on the property tax as a source of state and local government revenue is gaining momentum.

More states are adopting "circuit-breaker" laws. First enacted by Wisconsin in 1964, a circuit-breaker is designed to prevent residential property taxes from exceeding a percentage of income that is regarded as excessive. Generally, circuit-breaker provisions call for a state-paid rebate of taxes paid by homeowners (and, in some cases, renters) when property taxes exceed a certain percentage of household income.[3]

Circuit-breaker provisions also may be used to prevent unduly high property tax burdens on other classes of property. The circuit-breaker adopted by Michigan covers farmland as well as residential property, but other states have provided for special treatment of farm, timber, and open space land through differential assessment and tax deferral.

Several issues arise in any attempt to provide property tax relief:

1. Who should be given property tax relief?
2. How much tax relief should be provided?
3. How should the amount of tax relief be determined?
4. Should tax relief measures be funded locally or by the state?

A number of states have tried to reduce the pressure on local property taxes by increasing state aid to local units of government and providing alternative sources of local tax revenue. Most states also have constitutional or statutory provisions that limit local property tax rates or levies in some way.

Repeal of the Property Tax

Some advocates of tax reform argue that the property tax should be abandoned completely as a source of local tax revenue. Property taxes could then be levied on a state-wide basis or simply discarded in favor of other forms of taxation. These proposals raise two major issues:

1. Do local governments need their own source of tax revenue?
2. Would complete elimination of the property tax be desirable?

Many people agree that too large a share of public services are financed locally, but most apparently believe that some degree of autonomy for local units of government should be maintained. Local autonomy, it

[3] For a description of the principal features of state circuit-breaker programs, see Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism, 1978-79 Edition*, M-115 (Washington: U.S. Government Printing Office, 1979), pp. 64-68.

is argued, requires that local governments have their own direct source of tax revenue. It may be possible to maintain a system of strong local government without a local tax source, but most people seem to believe that a source of local tax revenue is essential.

If a local tax source is necessary, should it be the property tax? The major alternatives to the property tax are local sales and income taxes, which are used now by some local governments. However, many people argue that these forms of taxation offer no significant advantages over the property tax and may, in fact, have some serious disadvantages. The tax base of either a sales or income tax may be even less uniformly distributed than that of a property tax. Local sales and income taxes may be more easily avoided by taxpayers and subject to greater fluctuations as economic conditions change. Moreover, the property tax is familiar to taxpayers, and its administrative structure is already established.

Other Issues

A number of other proposals have been made for substantial modification of the property tax. Some have suggested that the property tax should be changed to a tax on net wealth. Wealth taxes are being used successfully in some other countries. It has also been suggested that the property tax should be applied only to land (site-value taxation) and not to improvements. This, it is argued, would increase the supply of housing and discourage urban sprawl.[4] Some also have suggested that property tax rates might be graduated according to the assessed value of taxable property that each individual owns.

[4] **For a discussion of site-value taxation, see Mason Gaffney, "An Agenda for Strengthening the Property Tax," in George E. Peterson, ed., *Property Tax Reform* (Washington: Urban Institute, 1973), pp.80-83.**

Future of the Property Tax

Despite its widespread criticism, the property tax is likely to remain a major source of tax revenue for local governments for years to come. If nothing else, the property tax has been durable; and such an important source of revenue is not apt to be quickly discarded. This makes it all the more important that attention be given to the defects of the property tax, and that every effort be made to improve it.

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In cooperation with NCR Educational Materials Project.

Issued in furtherance of Cooperative Extension Work, Acts of Congress May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture and Cooperative Extension Services of Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. Norman A. Brown, Director of Agricultural Extension Service, University of Minnesota, St. Paul, Minnesota 55108.