Bond Case Briefs

Municipal Finance Law Since 1971

The Downsides of Property Tax Caps.

They have created fiscal stress for states and municipalities, and exacerbated inequality. A new report offers a simple solution to alleviate those issues.

Property tax caps are hampering municipalities' ability to fund basic services and are exacerbating inequality, according to a report released by the Center for Budget and Policy Priorities (CBPP) last week.

The tax caps, which first became popular during the 1970s tax revolt and have since spread to 44 states plus the District of Columbia, have created fiscal stress for the states that adopted the limits. As a result, states have cut aid to cities and counties, and municipalities have become more reliant on sales taxes and fees that disproportionately hurt the poor and people of color.

Prior to the first state cap in 1977, property taxes accounted for an average of 50 percent of local revenue across the country, according to the report. In 2015, property taxes accounted for 39 percent of local revenue.

Property tax revenue is shared by states and their localities. The study focused on the impact of caps in Michigan, Massachusetts, Oregon and New York. When adjusted for inflation, Massachusetts cut its unrestricted aid to municipalities by 44 percent from 2001 to 2015. In New York, more than three-quarters of cities and half of the counties reported significant fiscal stress due to the state's adoption of its tax cap in 2011 and subsequent cuts in state aid. And in Michigan, state aid declined in every city outside of Detroit from 2008 to 2014, dropping 17 percent across the state.

Because of property tax caps, "states are pushing too many costs down to the lower level," said Ron Deutsch, executive director of the Fiscal Policy Institute, during a press call about the report.

Property tax caps, according to the analysis, also contribute to inequality. For one, the caps strangle funding for public education, which the researchers see as a pathway for minority and low-income children to move up the socioeconomic ladder.

"I think in particular with schools we have a great imbalance between our high-needs school districts and our well-off school districts in terms of per pupil spending. The tax cap is institutionalizing these inequities," Deutsch said.

Secondly, white homeowners reap the largest benefits from the cap because they have historically owned homes at a greater rate than people of color and on average own more valuable homes.

And because the caps have led municipalities to turn to fees and sales taxes to make up the difference, those costs fall disproportionately on poor residents and people of color since they account for a larger portion of their income. Across the country, the share of local revenues derived from fees went from 16 percent in 1977 to 23 percent in 2015.

"Property tax caps lock in those inequities," says Iris Lav, former deputy director of the Center for Budget Policy and Priorities.

The study points to a report from the U.S. Department of Justice that examined the use of fees in Ferguson, Mo., and warned of "the illegal enforcement of fines and fees in certain jurisdictions around the country — often with respect to individuals accused of misdemeanors, quasi-criminal ordinance violations, or civil infractions." The DOJ report went on to explain that people facing these fines and fees "may confront escalating debt; face repeated, unnecessary incarceration for nonpayment despite posing no danger to the community; lose their jobs; and become trapped in cycles of poverty that can be nearly impossible to escape."

A Proposed Solution

The report has a recommendation to alleviate some of these issues: Flip the current property tax cap formula.

Right now, most states limit the annual increase in property taxes to 1.5 or 2.5 percent or the rate of inflation — whichever number is lower. Setting the limit instead at whichever number is higher, the researchers say, would provide more cash for governments and make revenues more predictable.

"We never thought the tax cap was the right solution," said Deutsch. "Property tax caps should be eliminated. If they aren't eliminated, at the very least, they should be amended."

To control runaway costs for homeowners living on more modest incomes, states could adopt "circuit breakers," which caps property taxes for people who make below a certain amount.

The report is being released in a year when federal tax reform is being upended. President Trump signed a tax package in December that caps the mortgage interest deduction and the state and local tax deduction. New York is one of four states suing the federal government over both.

The states claim the mortgage interest deduction cap violates the 10th Amendment, which protects states' rights. Furthermore, they contest the tax reform was intended to undermine their ability to raise taxes and point to Treasury Secretary Steven Mnuchin's statement this year that the cap was intended to "send a message" to high-tax states.

"The capping of SALT deductions has made it harder for states to raise the revenue they need to rely on," says Michael Leachman, CBPP's senior director of state fiscal research. "We are seeing it play out that people are not willing to pay higher property taxes."

GOVERNING.COM

BY J. BRIAN CHARLES | JULY 26, 2018

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com