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State Limits on Property Taxes Hamstring Local Services and Should Be Relaxed or Repealed

Michigan, Massachusetts, Oregon, and New York Reveal Range of Problems With Limits

By Iris J. Lav and Michael Leachman

Beginning in the 1970s, many states adopted new limits that sharply reduced funding for education and other important services by capping property taxes. The time has come for states to reconsider these harsh limits, which have put severe pressure over time on local governments' ability to deliver the services that their residents expect and need, from schools and police and fire protection to city parks and affordable housing initiatives. Property tax limits also hamstring localities' ability to provide services that boost opportunity for their residents. And they increase racial and economic inequities, in part by leading localities to use revenue sources that fall harder on lower-income people. In these ways, property tax limits harm the quality of life of our communities and make it much harder to produce broadly shared prosperity.

States haven't made up the revenue that localities have lost due to property tax limits — sometimes even when the limits supposedly required them to do so — and some states have *cut* local aid. Massachusetts, for example, initially raised aid to localities after the 1980 passage of its property tax limit, but after enacting major income tax cuts it slashed unrestricted local aid by 44 percent between fiscal years 2001 and 2015, adjusted for inflation, according to the Massachusetts Budget and Policy Center. The federal government hasn't stepped up, either. State and federal aid has declined as a share of local revenue since the late 1970s.

As a result, local governments have cut services and now rely more heavily on less desirable forms of revenue such as sales taxes and fees. These trends have resulted in less funding for schools and other local services. One study of spending by Michigan cities other than Detroit found that total spending fell by more than 17 percent between 2008 and 2014, after adjustment for inflation. Funding declined for every category of services: for instance, police and sheriff by 13 percent, fire by 14 percent, parks and recreation by 27 percent, and health and human services by nearly 8 percent.

The shift to sales taxes and fees also increased income disparities because they are more regressive than property taxes are. Property tax limits appear to increase localities' reliance on fees to fund services, from community college tuition and hospital fees to fees for student athletic participation and occupational licensing. This may be particularly problematic when the fee increases occur in the

area of courts and police services, a recent trend that has exacerbated racial inequities and undermined public trust in the criminal justice system. A U.S. Justice Department report 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." As the report explained, 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."

Property tax limits also have expanded racial income gaps by providing disproportionate savings to white homeowners, who are more likely than African Americans or Latinos to own expensive homes, in part because past government policies segregated people of color in lower-value areas. And limits have created other problems as well, some of them unintended. In Oregon, for example, similarly valued homes can receive drastically different tax treatment because the state's limits do not reset when a property is sold but instead are permanently attached to the property. Some homeowners in Portland actually pay *more* property tax than they would without the limits.

This report looks at the problems that property tax limits have caused across the country and focuses on four states: Michigan, Massachusetts, Oregon, and New York. (See box for description of the limits in each state.) These states reveal the range of problems that property tax limitations typically cause. Every state with a property tax limit would do well to examine the consequences of its limit and consider relaxing or repealing it. States can employ more targeted alternatives, such as circuit breakers (which provide refunds to households whose property taxes are deemed too high) and homestead exemptions (which exempt a flat amount of home value from the tax), to relieve property taxes for seniors and others who might have difficulty affording them.

Property taxes are an important component of a healthy state-local revenue system, and limits interfere with this important role. It is helpful for states and localities to use a variety of taxes that exhibit different properties across the business cycle and tax different aspects of residents' behavior. Property taxes have historically been more stable than income or sales taxes; if they do decline in recessions, they usually do so with a lag, even as other revenue sources are recovering. And they are, at least in part, a tax on wealth rather than income or consumption, adding diversity to revenue sources.

As states repeal or reform property tax limits, they can reduce the pressure for property tax increases by strengthening other revenue sources. Possible steps include raising personal income taxes for high-income residents who have gained the most from rising inequality, adopting or expanding state inheritance and estate taxes, closing loopholes that allow profitable corporations to avoid taxes, and other measures that ask the wealthy to contribute at least as much of their income in state and local taxes as middle- and low-income families. The federal government can also help by increasing — or at least not further cutting — funding for schools, infrastructure, and other national priorities delivered at the state and local level.

States Constrain Local Property Taxes

The property tax is primarily a local government tax and can be a flexible revenue source to support schools and locally provided public services. In its purest form, it is based on an assessment of the market values of all properties in a jurisdiction. Once these values are established, the jurisdiction applies a tax rate to yield the amount of revenue needed to support the desired level of services. Property tax limits interrupt this calculation. Some constrain the percentage by which assessed values can grow each year, others limit the property tax rate, and still others — the most severe — limit the percentage growth in property tax revenue each year. These last are known as levy limits.

Although property taxes are primarily a local revenue source, states largely control the conditions under which they are administered. Property tax limits generally are enacted by states and cover an entire state. Some states have statutory limits enacted by legislatures; others have constitutional limits, which generally required approval by voters.

Property tax limits date far back to the 19th century,[1] but the late 1970s was by far the most significant period for states adopting limits. The number of state-imposed limits nearly doubled in the 1970s and 1980s, as levy and assessment limits first became widespread. Today, 44 states and the District of Columbia impose at least one kind of limit, and many use a combination of limits. (See Appendix.)

Since the late 1970s, the property tax has shrunk considerably as a local revenue source. Between 1977 and 2015, property tax revenue nationally fell from 50 percent of local governments' own-source revenue to 39 percent, Census data show. (See Figure 1.) Over that same period, local government property tax collections fell from 3.7 percent of personal income to 3.0 percent.[2]

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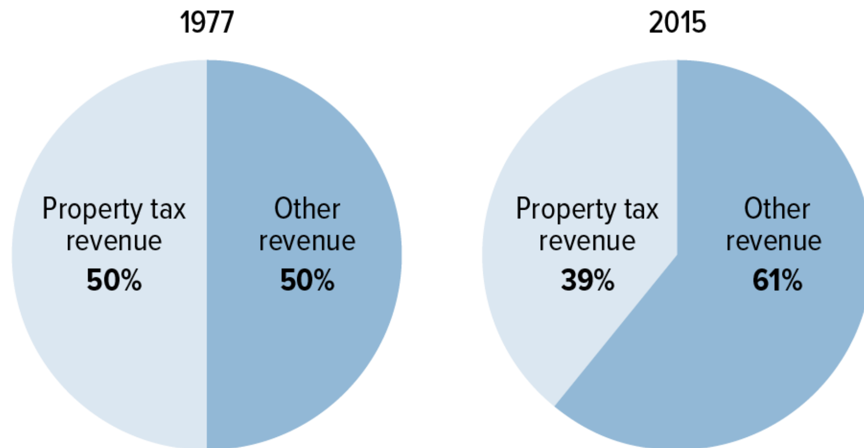
[1] See Bethany Paquin, "Chronicle of the 161-Year History of State-Imposed Property Tax Limitations," Lincoln Institute for Land Policy, Working Paper WP15BP1, April 2015, https://www.lincolninst.edu/sites/default/files/pubfiles/paquin-wp15bp1.pdf. See also Katherine Newman and Rourke O'Brien, *Taxing the Poor: Doing Damage to the Truly Disadvantaged,* University of California Press, 2011.

[2] State & Local Government Finance Data Query System, https://slfdqs.taxpolicycenter.org/pages.cfm, Urban Institute-Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments.

FIGURE 1

Property Tax Has Declined as Share of Local Revenue

Property tax as percent of revenue that local governments raise on their own



Source: Urban-Brookings State and Local Government Finance Data Query System, 2018

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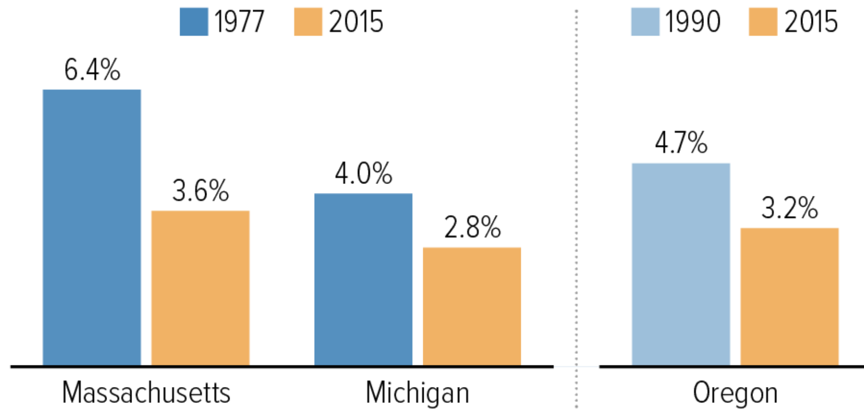
The decline is even more evident in states with long-standing property tax limits, which include three of the four focus states for this report: Massachusetts, Michigan, and Oregon. Between 1977 and 2015, property taxes fell from 6.4 percent of personal income to 3.6 percent in Massachusetts and from 4 percent of personal income to 2.8 percent in Michigan. In Oregon, property taxes fell from 4.7 percent of personal income in 1990 (when the first limit was enacted) to 3.2 percent in 2015.[3] (See Figure 2.)

[3] *Ibid.*

FIGURE 2

In States with Limits, Property Taxes Have Fallen Sharply as Percent of Personal Income



Source: Urban-Brookings State and Local Government Finance Data Query System, 2018

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Four State Examples of Property Tax Limits

This report considers property tax limits in four states: Michigan, Massachusetts, Oregon, and New York. While their individual provisions differ, all are highly restrictive.

Michigan: Michigan has two property tax limits in its constitution. The 1978 Headlee Amendment limited annual property tax revenue growth to the rate of inflation, and requires a rollback of property tax rates if the increase in assessed value would lead revenue growth to exceed inflation. The 1994 Proposal A substituted sales taxes for property taxes as the major school funding source and limited the annual growth in taxable property value (which is different than assessed value) to the rate of inflation or 5 percent, whichever is less.

Proposal A also created a "ratchet" in property tax valuation. There is no limit to the extent to which valuation can *drop,* but Proposal A limits the annual *increase* from that reduced valuation. It can take many years for property to regain its former taxable value after a sharp drop, as occurred in the Great Recession. In addition, Proposal A includes new construction under the limit.

Together, the Headlee Amendment and Proposal A sharply curtail localities' ability to provide adequate services, particularly after a recession. Through a "Headlee override," a local government may ask voters to increase the millage (tax rate) above its current rate, but no higher than the original rate authorized when the Headlee Amendment was enacted. Proposal A specifies that a portion of state sales tax revenues must be devoted to K-12 education in order to offset some of the loss of property tax. (Prior constitutional amendments provided some revenue sharing to support other local services.)

Massachusetts: Massachusetts voters passed the statutory Proposition 2½ in 1980 through the initiative process. It limits property tax *collections* to 2.5 percent of the assessed value of a community's property and limits *increases* in property tax collections to 2.5 percent per year, with upward adjustments for increases in the tax base not resulting from revaluation of existing property. A community's residents can, by majority vote, permanently increase property tax collections by more than 2.5 percent annually, so long as collections do not exceed 2.5 percent of assessed value. Residents also may vote to temporarily exceed either of the 2.5 percent limits to cover certain capital expenditures or debt service costs.

Oregon: Oregon has three constitutional property tax limits. Ballot Measure 5, enacted in 1990, fixed the property tax rate at 1.5 percent of assessed value and required the state to replace lost revenue to schools, education services, and community colleges. Measures 47 and 50, enacted in 1996 and 1997, capped annual growth in total assessed value to 3 percent and required a 10 percent rollback of assessments for residential property. Unlike many other states' limits, the Oregon limits do not reset when a property is sold but instead are permanently attached to the property, which creates large disparities over time between existing and newly built property.

Most taxing districts can ask voters for temporary taxing authority above the permanent rate limitation, known as a "local option tax." Local option taxes are limited to five years for operational expenses and ten years for capital construction purposes. Voters can also approve additional levies for bond indebtedness. Under certain circumstances, voters may also create special districts with tax-levying power, but under the state's complex rules such a move risks redistributing revenue rather than increasing it.

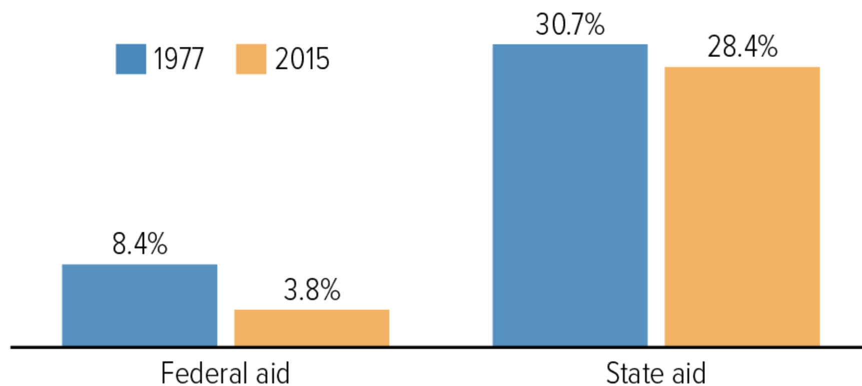
New York: New York's statutory cap, enacted in 2011, limits the annual growth in property taxes levied by school districts and local governments to 2 percent or inflation, whichever is less. It does not apply in New York City or a few large school districts. The limit can be overridden by 60 percent of voters (for school districts) or 60 percent of the total voting power of the governing body (for local governments).

States and Federal Government Have Exacerbated Localities' Problems

State property tax limits might have caused less harm to residents if either states or the federal government had made up for the lost local revenue. But that generally did not happen, sometimes even in states whose limits required the state to make up the lost local revenue. To the contrary, federal aid to localities fell from 8.4 percent of total local revenue in 1977 to 3.8 percent in 2015, while state aid to localities dropped from 30.7 percent of total local revenue to 28.4 percent.[4] (See Figure 3.)

FIGURE 3

State and Federal Aid Have Fallen as Percent of Local Revenues



Source: Brookings-Urban State and Local Government Finance Data Query System, 2018

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In some states, income tax cuts have left inadequate revenue available to sustain previous levels of support for localities. For example, income tax cuts in Massachusetts led to a 44 percent reduction in unrestricted state aid to localities, after adjusting for inflation.[5] After Maine enacted major income tax cuts, the state scaled back aid for localities, ultimately cutting the amount of aid from 5 percent of broad-based taxes to 2 percent.[6] And income tax cuts in Kansas made it very difficult to restore recession-era cuts in aid to localities, which remains down 14 percent since 2009 after adjusting for inflation.[7]

Further cuts in federal and state aid to cities, towns, and schools are likely. The federal tax bill enacted late in 2017 limits the deduction for state and local tax payments, which will affect the ability of states (and localities) to sustain or increase their taxes to meet needs. And when a state has

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[4] *Ibid.*

[5] Kurt Wise and Marie-Frances Rivera, "Income Tax Cuts and the Budget Deficit in Massachusetts," Massachusetts Budget and Policy Center, January 21, 2015, http://massbudget.org/report_window.php?loc=tax_cuts_factsheet.html.

[6] Email from Sarah Austin, Maine Center for Economic Policy, July 10, 2018.

[7] Kansas Center for Economic Growth, "Aid to Locals Report: 2017 Update," September 2017, https://realprosperityks.com/wp-content/uploads/2013/02/KCEG_AidToLocalsReport_v7.pdf.

difficulty balancing its budget — whether because of federal actions, a recession, or other reasons — aid to localities typically is among the first places it cuts. In addition, the Trump Administration and Republican congressional leaders have proposed massive cuts in federal grants to state and local governments.[8]

The failure of state aid to make up for the revenue lost to local property tax limits is evident in the focus states of this report.

- **Michigan** has constitutional and statutory requirements regarding the share of sales tax revenue that the state should distribute to cities, villages, and townships. However, the actual amount of statutory revenue sharing the state provides depends on appropriations, which can fall short of the specified statutory amount.[9] A House Fiscal Agency report shows that state revenue sharing payments to cities, villages, and townships have not been fully funded since 2001 — and the gap keeps growing.[10] (See Figure. 4.) Michigan local governments received more than 39 percent of their total revenue from state aid in 2015, so shortfalls in state aid can have a large impact on local budgets.[11]

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[8] The federal tax changes enacted at the end of 2017 will increase federal deficits by $1.9 trillion over the next ten years, according to the Congressional Budget Office. Republican leaders have repeatedly said that after enacting the tax bill, they will turn to budget cuts. The congressional budget resolution that Congress approved in October 2017, which created the process and set the parameters for the tax bill, also calls for $5.8 trillion in budget cuts over the coming decade. President Trump's 2018 budget would have deeply cut funding for programs states and localities deliver. By 2027 those cuts would be equivalent to 37 percent of state budgets. Iris J. Lav and Michael Leachman, "The Trump Budget's Massive Cuts to State and Local Services and Programs," Center on Budget and Policy Priorities, June 13, 2017, https://www.cbpp.org/research/state-budget-and-tax/the-trump-budgets-massive-cuts-to-state-and-local-services-and. The President's 2019 budget proposed similar cuts. Center on Budget and Policy Priorities, "The 2019 Trump Budget: Hurts Struggling Families, Shortchanges National Needs," February 20, 2018, https://www.cbpp.org/research/federal-budget/the-2019-trump-budget-hurts-struggling-families-shortchanges-national-needs.

[9] The statutory revenue sharing requirement has never been repealed, but the legislature has changed the formulas for distribution and the amount of the distribution many times since 2002.

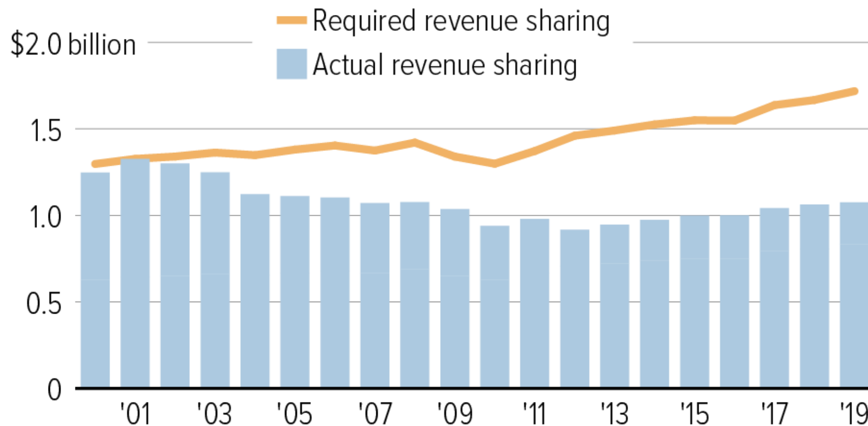
[10] Jim Stansell, "Budget Briefing: State Revenue Sharing," Michigan House Fiscal Agency, September 2017, http://house.michigan.gov/hfa/PDF/Briefings/State_Revenue_Sharing_fy17-18.pdf.

[11] Urban-Brookings State and Local Finance Data Query System.

FIGURE 4

Michigan's Revenue Sharing Falling Further Behind Required Levels

Revenue sharing payments to cities, villages, and townships



Note: Michigan has constitutional and statutory requirements regarding the share of sales tax revenue that the state should distribute to localities, but for nearly two decades, policymakers have provided less than the required amount each year. Actual data for fiscal year 2018 are not yet available, so figures are based on estimates. Data for fiscal year 2019 are based on executive recommendations.

Source: Michigan House Fiscal Agency, "State Revenue Sharing," 2018

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- **Massachusetts** initially raised aid to localities after the 1980 passage of Proposition 2½,[12] but aid fell substantially after the state made major, phased-in cuts in its personal income tax between 1998 and 2002, which resulted in a continuing revenue loss. As mentioned above, unrestricted[13] state aid to localities fell by 44 percent between fiscal years 2001 and 2015, adjusted for inflation.[14] The income tax cut left the state without the resources to compensate for the local effects of Proposition 2½.[15]
- **Oregon**'s aid to local governments grew as a percentage of local government general revenue from 1990 (when Ballot Measure 5 was enacted) through 2002 but has since fallen. If state aid

[12] State aid to localities rose from 1981 through 1989, declined in the recession of the early 1990s, and then grew again through 2001.

[13] Unrestricted aid is aid to localities for purposes other than education.

[14] Wise and Rivera, "Income Tax Cuts and the Budget Deficit in Massachusetts," http://massbudget.org/report_window.php?loc=tax_cuts_factsheet.html.

[15] The 2018 Massachusetts budget did increase both local aid and school aid. But the Massachusetts Municipal Association reports that Unrestricted General Government Aid will still be $621 million lower than it was ten years ago, after adjustment for inflation. See "Full municipal aid increase necessary for local fiscal stability," June 1, 2017, https://www.mma.org/full-municipal-aid-increase-necessary-local-fiscal-stability.

in 2015 had constituted the same percentage of local general revenue as it did in 2002, it would have been 14 percent greater.[16]

Limits Have Forced Cuts in Local Services

Constrained by the limits on their ability to raise revenues, local governments and schools have little choice when hitting property tax limits but to cut spending, often with serious consequences for residents.

Michigan's two constitutional property tax limits, for example, made it extremely difficult for localities to recover from the Great Recession. That's largely because one of the limits (Proposal A) allows taxable values to fall during recessions but then limits their growth during an economic recovery. This "ratchet" effect makes it nearly impossible for local revenues to recover even as the economy improves, putting serious strain on local budgets.

The result is that Michigan's local governments have faced serious financial difficulties. By 2014, 17 local governments and school districts in the state were experiencing severe fiscal distress and were operating under the control of state-appointed emergency financial managers. As a Michigan State University report noted, "Michigan's particular mix of stringent limitations on local revenue and its relatively low level of financial assistance to cities, coupled with spending pressures stemming from spiking local service burdens and increased labor costs, create conditions that drive up the potential for local fiscal distress."[17] An important element of that distress was the constraints on property tax revenue, which fell from 57 percent of local governments' own-source revenue in 1978 to 44 percent in 2015, a drop of nearly one-quarter.

Localities responded to these serious challenges in large part by cutting spending for services. One study of spending by Michigan cities other than Detroit found that total spending fell by more than 17 percent between 2008 and 2014, after adjustment for inflation. Every category of services saw declines. For example, the police and sheriff category fell by 13 percent, fire by 14 percent, parks and recreation by 27 percent, and health and human services by nearly 8 percent.[18] (See Table 1.)

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[16] The general revenue of Oregon localities in 2015 was $18.5 billion, while aid to localities was $6.3 billion, or 34.3 percent of general revenues. If aid had remained at the 2002 level of 38.9 percent of general revenue, it would have been $7.2 billion, or 14 percent higher than it was. State & Local Government Finance Data Query System.

[17] Joshua Sapotichne *et al.,* "Beyond State Takeovers: Reconsidering the Role of State Government in Local Financial Distress, with Important Lessons for Michigan and its Embattled Cities," Michigan State University Extension, August 31, 2015.

[18] Great Lakes Economic Consulting, "Michigan's Great Disinvestment; How State Policies Have Forced Our Communities into Fiscal Crisis," April 2016. Inflation adjustment by CBPP.

TABLE 1

Michigan Cities Cut Spending Deeply After Great Recession

Expenditures in millions of 2014 dollars; excludes Detroit

City Expenditures	2008	2014	Percent Change, 2008 – 2014
General Government	$711	$557	-22%
Police/Sheriff	$888	$771	-13%
Fire	$468	$401	-14%
Other Public Safety	$213	$205	-4%
Parks and Recreation	$175	$127	-27%
Public Works	$308	$268	-13%
Health & Human Services	$9	$8	-8%
Redevelopment, Planning, Housing	$58	$52	-11%
Cultural	$36	$22	-39%
Capital Outlay	$38	$37	-2%
Debt Service	$26	$17	-34%
Fringe Benefits	$159	$87	- 45%
Transfers Out	$233	$194	-17%
Other Expenditures	$17	$10	- 44%
Total Expenditures	$3,339	$2,756	-17%

Note: Expenditure values have been rounded to the nearest million. Percent change calculations may not match due to rounding.
Source: Great Lakes Economic Consulting, *Michigan's Great Disinvestment: How State Policies Have Forced Our Communities into Fiscal Crisis,* April 2016. Inflation adjustment by CBPP.

New York's property tax cap for school districts, counties, and cities, which limits annual revenue growth to the lower of inflation or 2 percent, has seriously constrained revenues and spending in counties and cities since its 2011 enactment. Between 2011 and 2016, as the national economy gradually improved, total spending by counties *fell*, with some services seeing extremely sharp declines. Education spending by counties declined 5 percent, social service spending dropped 8 percent, and spending on health services and community services fell a remarkable 21 percent and 25 percent respectively, after adjustment for inflation.

Total spending for New York cities was nearly flat, averaging an inflation-adjusted growth of 0.07 percent per year. Spending on public safety, social services, economic development, and culture and recreation all declined.[19]

In a January 2017 report, New York State Comptroller Thomas P. DiNapoli wrote: "New York's local governments continue to face significant constraints in revenue growth, making it difficult for them to maintain services while keeping pace with rising fixed costs, such as health care."[20]

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[19] New York State Office of the Comptroller, Local Government Data, http://www.osc.state.ny.us/localgov/datanstat/findata/index_choice.htm. Inflation adjustments by CBPP.

[20] Office of the New York State Comptroller, "2016 Annual Report on Local Governments," January 2017.

In a 2017 Cornell University survey of local governments in New York State (excluding New York City), 77 percent of cities and 58 percent of counties reported moderate or significant fiscal stress. The major sources of stress were the tax cap, cuts in aid to localities, and state mandates. Looking specifically at the tax cap, 77 percent of local governments indicated that the cap significantly or moderately impaired their current budgetary needs, and 88 percent indicated that it impaired their future needs.[21]

Survey respondents reported that infrastructure — particularly road repair — and planning are the budget needs most affected by fiscal stress; cuts to infrastructure, economic development, and planning will have long-term impacts. Localities also reported that they are cutting recreation and elder services (especially in cities, where 41 percent reported cuts). Social services are least likely to be affected by fiscal stress because state mandates require these services regardless of local budgetary limitations. There nevertheless have been significant cuts in social services, as the comptroller's data cited above show.

Localities Have Turned to Less Desirable Revenue Sources

When localities in states with property tax limitations have sought to avoid significant spending reductions, they typically have tapped other revenue sources that may be available to them. These choices have major consequences for lower-income populations and communities of color, since the other major sources of local government revenue — such as sales taxes and fees — typically fall harder on those with the least income than do property taxes.

In some states, localities are allowed to institute or raise general sales taxes.[22] These are localities' second-largest revenue source after property taxes, and so a likely option for localities in which harsh limits have been imposed. Indeed, sales taxes increased from 6.9 percent of local government own-source revenues nationally in 1977 (before the "property tax revolt" began) to 9.4 percent in 2015.

Since sales taxes are far more regressive than property taxes, this shift has worsened income inequality, which has already widened sharply over recent decades. As Figure 5 (which uses data from the Institute on Taxation and Economic Policy) shows, low- and middle-income families pay a higher percentage of income for sales taxes than property taxes.

Another option generally open to localities is to increase fees for services such as sewerage, trash pick-up, community college classes, and participation in school athletics or other extracurricular activities. Like sales taxes, fees typically fall hardest on those with the least ability to pay. In Oregon, for example, fee increases resulted in a shift in who pays for local services from property owners to users of certain services. As one study of Oregon's complex property tax limits noted:

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[21] Austin M. Aldag, Mildred E. Warner, and Yunji Kim, "What Causes Local Fiscal Stress? What Can Be Done About It?" Cornell University, May 2017, http://cms.mildredwarner.org/p/268.

[22] States control the types of revenues that localities and schools can raise. Local general sales taxes exist in 38 states, although not necessarily in all localities in those states; the other states do not permit them. "Tax Policy Center Briefing Book: State (and Local) Taxes," http://www.taxpolicycenter.org/briefing-book/how-do-state-and-local-sales-taxes-work.

> Depending on the growth of assessed value, a taxing district's revenue may grow slowly, or even decline, from one year to the next. This was a fundamental component of Measure 50. . . . But citizens, who depend on police, fire, library, public health and education services, continue to depend on those services even when the assessed values within the district decline. Taxing districts across the state with low rates of assessed value growth are caught in the middle, expected to provide the same services as before, even when property taxes are flat or declining…. Districts have responded by implementing more and more user fees, transferring responsibility for paying for certain services from the general property tax system (property owners) to those who use a particular service (citizens). Community college tuition has increased. School districts charge more for participation in athletics, music, and drama.[23]

Indeed, local government fees and charges for services have increased as a percent of local own-source revenues throughout the country in recent decades as property tax caps have proliferated. All three states considered here with long-standing property tax limits have had significant increases in the use of fees since 1977, before the "property tax revolt" began. (See Figure 6.)

Even in the short time New York's limit has been in effect, localities have resorted to raising user fees. The Cornell survey described above found that 62 percent of cities increased existing user fees and 31 percent imposed new user fees. Among counties, 45 percent increased user fees and 17 percent adopted new fees.[24]

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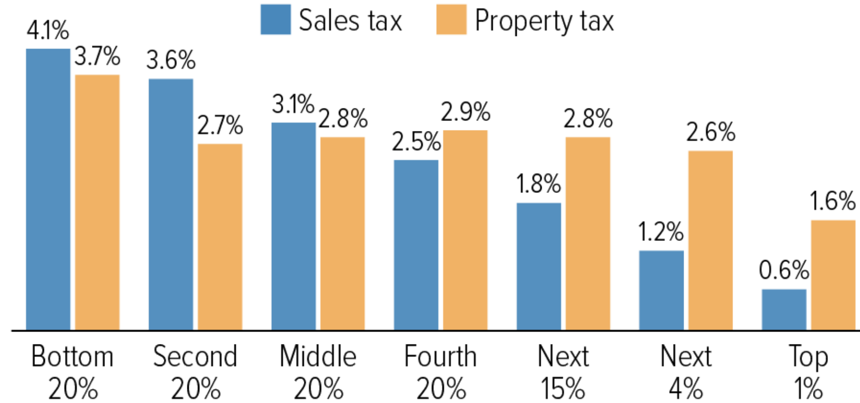
[23] Tom Linhares, "Recent History of Oregon's Property Tax System: With An Emphasis on Its Impact on Multnomah County Local Governments," December 2011, https://www.lanecounty.org/UserFiles/Servers/Server_3585797/File/Government/County%20Departments/Assessment%20and%20Taxation/General%20Info/Recent_History_Nov_2011.pdf.

[24] Aldag *et al.*

FIGURE 5

Sales Taxes Fall More Heavily on Low- and Moderate-Income Households than Property Taxes

Sales tax vs. property tax as percent of non-elderly households' income for every $100 billion that the tax raises, 2015



Note: Since the sales tax and property tax raise different amounts of revenue, this graphic shows the impact on households for each $100 billion raised by each tax. Holding the amount raised constant provides an apples-to-apples comparison of the distributional impact of each tax. These are national averages and include taxes paid indirectly, as when businesses pass taxes along to consumers through higher prices or when landlords pass taxes along to tenants through higher rents.

Source: Institute on Taxation and Economic Policy, March 2018

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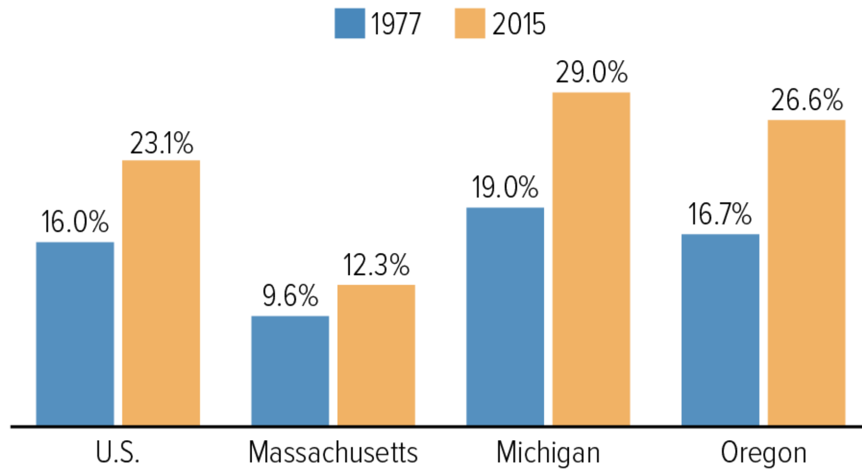
Fees are especially burdensome for low-income residents because they typically are a flat amount for all residents regardless of income and thus represent a larger share of their income. For example, a $50 fee to participate in the school band is harder to pay for a parent working at minimum wage than for a millionaire.



For low-income people and people of color, some of the most burdensome fees are connected to criminal justice systems. For example, the unrest in Ferguson, Missouri in 2014 helped bring public attention to the widespread misuse of fines and fees to raise revenue. (Missouri has had a limit on property tax revenue since 1980.) With respect to fines and fees in the criminal justice system, the U.S. Department of Justice noted:[25]

> Recent years have seen increased attention on 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. Typically, courts do not sentence defendants to incarceration in these cases; monetary fines are the norm. Yet the harm caused by unlawful practices in these jurisdictions can be profound. Individuals 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. Furthermore, in addition to being unlawful, to the extent that these practices are geared not toward addressing public safety, but rather toward raising revenue, they can cast doubt on the impartiality of the tribunal and erode trust between local governments and their constituents.

[25] Letter from U.S. Department of Justice, Civil Rights Division, Office for Access to Justice, March 14, 2016.

An accompanying press release noted that these practices are "particularly severe for the most vulnerable members of our communities, often with a disproportionate impact on racial minorities."[26]

The harm done by fees and fines in Ferguson is not an isolated incident. Local governments around the country often rely on fees and fines related to criminal proceedings to raise revenue, sometimes resulting in harmful and unnecessary consequences, especially for low-income families and communities of color. At a Las Vegas meeting of Nevada's advisory committee to the U.S. Commission on Civil Rights, civic leaders explained that administrative fees for traffic violations can easily exceed the original fine, and in many instances, failure to pay leads to incarceration. Participants also noted that requiring low-income parents to pay for overnight stays in juvenile justice facilities or foster homes can result in children remaining in those facilities longer than is necessary or advisable.[27] Other criminal justice fees include charges for representation by a public defender, missed court appearances, room and board for jail or prison stays, parole or probation services, court-required drug testing, counseling or community service, and electronic monitoring devices.[28]

Evidence suggests that the use of fines and fees as part of the punishment for a criminal offense has been increasing. In 1986, 12 percent of those incarcerated were also fined; by 2004 this number had risen to 37 percent — and to 66 percent if one also includes fees. For example, the number of states charging fees for probation and parole supervision rose from 26 in 1990 to 44 in 2014.[29]

Limits Reduce Opportunity and Increase Inequities

Property tax limits not only encourage a shift from property taxes to sales taxes and fees, which increases burdens on low-income people and people of color, but also reduce opportunity and increase inequality, making it harder to create a desirable economy and quality of life.

In part because of historical racism and current discrimination, taxing jurisdictions in the United States are segregated by race, and property values tend to be higher in areas where white residents are concentrated. These "white" jurisdictions require relatively low property tax rates to fund adequate public services, since property values are higher. As a result, white homeowners typically pay lower effective property tax rates than African American or Hispanic homeowners.[30]

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[26] Department of Justice, Office of Public Affairs, press release number 16-285, March 14, 2016 (updated April 28, 2016).

[27] Lucy Hood, "Civic Leaders Say Municipal Fees Burden Low-income, Minority Communities," *Las Vegas Review-Journal*, March 15, 2017. Nevada has a property tax rate cap, a cap on the amount that the tax on individual properties can increase each year, and a levy limit.

[28] "Fines, Fees, and Bail: Payments in the Criminal Justice System that Disproportionately Impact the Poor," Council of Economic Advisers Issue Brief, December 2015.

[29] *Ibid.*

[30] Isaac William Martin and Kevin Beck, "Property Tax Limitation and Racial Inequality in Effective Rates," *Critical Sociology,* Vol.43(2), 2017, pp. 221-236.

Since past government policies helped segregate neighborhoods by race and so are partly responsible for these inequities,[31] it would be appropriate for today's public policies to help overcome the racial bias that remains embedded in today's effective property tax rates. Instead, property tax limits tend to *lock in* these inequities. For one thing, the dollar savings from a property tax limit typically will be greater for owners of high-value homes, who are more likely to be white (due in part to policies that blocked African Americans from buying homes in higher-value jurisdictions). Those greater dollar savings for white households will increase racial gaps in income and wealth. Further, disparities will grow over time whenever property values rise more quickly in areas with more high-value homes, increasing the relative value of a property tax limitation.

In such circumstances, property limits typically provide more benefit to white homeowners, who are more likely than African Americans and other people of color to own high-value homes. One recent study found that whites received about 89 percent of the total tax savings from property tax limitations nationally in 2011. The authors wrote:

> [M]ost forms of property tax limitation exacerbate racial inequality, providing the greatest reduction in effective tax rates to white homeowners. . . . American homeowners do not benefit equally from property tax limitation because Americans are sorted by race into different wealth classes, and because homeowners are sorted by race *and* wealth into different taxing jurisdictions with different effective tax rates."[32]

The study estimated that in 2011, property tax limits generated $2.8 billion in property tax savings for white homeowners that otherwise would have gone to non-white homeowners if the distribution of benefits from property tax limitation were distributed equally across racial groups. "This 'excess savings' exceeds *all* of the estimated property tax savings enjoyed by black homeowners under property tax limitation," the study notes.[33]

In addition, cuts in local services stemming from property tax limits may especially harm low-income communities and communities of color. Cuts in human services and public assistance, for example, likely cause additional hardships in low-income communities. Cuts in maintenance for sidewalks, streets, streetlights, and other public infrastructure may add to the difficulty of living in low-income neighborhoods and contribute to increased segregation by income and race as some neighborhoods become less desirable places to live — as famously occurred in Detroit, in part due to Michigan's property tax limits.

Property tax limits also have a substantial effect on the funds available for schools. They may directly constrain the growth in property taxes designated for schools, such as in Massachusetts and New York. Or they may shift school funding from the property tax to an alternate revenue source

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[31] See, for example, Richard Rothstein, *The Color of Law: A Forgotten History of How Our Government Segregated America*, Liveright, 2017.

[32] Martin and Beck, pp. 221, 232.

[33] *Ibid.* The authors' model implies that white homeowners received 89 percent of the tax savings from property tax limitations, or $56 billion. Had the tax savings from property tax limitations been distributed across racial and ethnic groups in proportion to their share of the property tax burden, white homeowners would have received 85 percent of the savings, or $53.2 billion. The $2.8 billion is the excess savings accruing to white homeowners.

that may not grow adequately to support a quality education. Michigan's limit, for example, shifted education funding to the sales tax; in general, sales tax revenues grow more slowly than the economy — particularly in a state such as Michigan, where the tax covers few services. Oregon's limit requires the state to fully replace the lost revenue for schools, educational services, and community colleges, effectively shifting funding for these programs to the income tax. (Oregon has no sales tax.) However, an Oregon Department of Revenue report noted that the state ended up meeting the requirement in part by cutting other basic school support funds that were no longer mandated.[34]

Indeed, Oregon has not adequately funded education, despite the requirement that the lost funds be replaced. Oregon public schools received 3.3 percent less funding per pupil from state sources in 2015 than they did in 2008, after adjusting for inflation.[35] A report from the Oregon Center for Public Policy notes:

> Older Oregonians will remember that their schools had school counselors, nurses and librarians. Today, many schools across our state lack these basic features of a quality school. The deficiencies of our educational system don't stop there. We have some of the nation's most crowded classrooms, some of the shortest school years, and low graduation rates. Many Oregon schools can't provide students rich course offerings in science, technology, engineering and math — the "STEM" courses that prepare children for the technological world which they will enter after graduation. Many schools also don't offer much in the way of arts, which help children develop their creativity and cognitive skills.[36]

Underfunding public education can increase inequality and cut off paths to social mobility — especially for lower-income children of color and newer immigrants, since higher-income families who find the public school lacking can often send their children to a private or parochial school. Also, votes to override property tax limits tend to be more successful in areas with higher-income residents (see below). And if a property tax limit takes effect when funding for schools in lower-income areas lags that of higher-income areas, the limit can lock in that disparity by constraining annual funding growth. For all these reasons, lower-income, minority, and immigrant children may be stuck in sub-par schools.

Limits Have Other Unintended and Harmful Consequences

Constraining property taxes often sets off a variety of other negative consequences. Many property tax limits lock in certain parameters such as assessments, tax rates, or total levies; many also squeeze down local government and school spending over time. When limits have been in place for an extended period, these features may become increasingly inequitable and unworkable, creating problems that policymakers may not have foreseen when enacting them. Here are a few examples:

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[34] Oregon Department of Revenue, "A Brief History of Oregon Property Taxation," http://www.oregon.gov/DOR/programs/gov-research/Documents/303-405-1.pdf.

[35] Michael Leachman *et al.,* "A Punishing Decade for School Funding," Center on Budget and Policy Priorities, November 29, 2017, https://www.cbpp.org/sites/default/files/atoms/files/11-29-17sfp.pdf.

[36] Chuck Sheketoff, "The Present and Past Funding of Oregon Schools," Oregon Center for Public Policy, October 2016, https://www.ocpp.org/2016/10/26/blog20161026-measure-97-schools-funding/.

- Because **Oregon's** property tax limits do not reset when a property is sold, similarly valued homes can receive drastically different tax treatment. The problem is especially acute in the Portland area, where "[p]roperties in fast price-appreciating neighborhoods pay lower taxes — relative to actual market value — than those in slower-appreciating neighborhoods."[37] This benefits higher-income people moving into gentrifying areas. Research from *The Oregonian* indicates that 57 percent of homeowners in the Portland metro area would pay less under a system based on market value rather than the one based on Measure 50 because the system has created such inequities over the years.[38]
- As mentioned above, in the aftermath of the Great Recession, **Michigan** local governments felt the punch of a Proposal A provision that allows property valuations (and thus property tax collections) to drop precipitously but limits annual increases from the depressed value as the economy recovers. As *Crain's Detroit Business* noted, "More than two decades after the law's landmark passage by voters under former Republican Gov. John Engler, the limits it forced on local revenue have been tested in ways that no one could have predicted in 1994, when the economy was growing."[39] According to Tony Minghine, chief operating office of the Michigan Municipal League, "You never experienced declines like that so you never saw the math play out the way it did."[40]
- Allowing overrides of property tax limits could, in theory, prevent some harmful consequences. But overrides are very limited in **Michigan** and **Oregon** and require supermajorities in **New York**. Overrides are possible in **Massachusetts** with a majority community vote, so long as the override does not bring taxes over the ceiling of 2.5 percent of assessed value.[41] But studies find that higher-income communities have a higher override success rate and approve much larger increases in property tax collections.[42] This disparity can exacerbate the tendency for higher-income communities to provide better schools and services than low-income communities, potentially perpetuating inequality.
- Many property tax limits sound simple on the ballot but involve a fair bit of complexity when implemented — especially when the state must reconcile two limits enacted at different times, as in **Michigan** and **Oregon**. A tax assessor in Oregon said: "The present system is extremely complex to administer and very difficult to explain. When I am giving educational presentations in town halls, it takes an hour just to give a good 30,000-foot overview of how the system works. It's unfortunate that we have that complex of a system."[43] And while

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[37] John Tapongna and Kevin Frazier, "Budget Deficits During a Growing Economy? Signs of a Broken Fiscal System," *Local Focus*, March 2017, http://www.orcities.org/Portals/17/Publications/localfocus/March2017web.pdf.

[38] Elliot Njus, "Tax breaks for gentrifiers: How a 1990s property tax revolt has skewed the Portland area tax burden," *The Oregonian*, updated February 9, 2017, http://www.oregonlive.com/business/index.ssf/2015/09/measure_50_winners_and_losers.html.

[39] Lindsay VanHulle, "Funding Squeeze Could Prompt Proposal A Update," *Crain's Detroit Business,* February 26, 2017.

[40] *Ibid.*

[41] In 2016, there were 112 Proposition 2½ ballot questions in 78 cities and towns, 37 percent of which passed. Massachusetts Municipal Association, "Overrides and Debt Exclusions Go to Voters," June 2, 2017.

[42] Municipal Finance Task Force, "Local Communities at Risk: Revisiting the Fiscal Partnership Between the Commonwealth and Cities and Towns," 2005.

[43] Oregon League of Cities, *Local Focus*, March 2017, www.orcities.org.

proponents often argue that property tax limits create certainty for taxpayers by limiting their potential tax increase each year, the complexity of state limits can also create considerable uncertainty about the quality of local schools and the services available in the community, since the limits force cuts over time. Moreover, a household's total tax bill, counting increases in user fees and sales taxes, may be higher than before the limits were instituted.

States Can Adopt Better-Targeted Property Tax Policies

States have better alternatives to relieve property taxes for middle- and low-income taxpayers and seniors, who might have difficulty affording the taxes. Two such alternatives are circuit breakers and homestead exemptions.

Circuit breakers provide a refund from state revenue to households whose property tax payments are deemed unaffordable (usually because they exceed a specified proportion of the household's income). They allow the property tax to continue funding essential services like education while targeting assistance to those who need it.

In 2017 some 14 states and the District of Columbia used circuit breakers, and 15 other states provided property tax credits to some low-income families based on their income.[44] However, many circuit breaker programs are only available to elderly or disabled residents or to very low-income households. States could make far greater use of this strategy to extend property tax relief to overburdened middle- and low-income households. In conjunction with relaxing or eliminating a property tax limit, states could create or improve a circuit breaker to cover all residents whose property tax exceeds a specified proportion of their income. The vast majority of the benefits would go to low- and middle-income households.

Another strategy is to create or expand a homestead exemption in conjunction with relaxing or eliminating a property tax limit. A homestead exemption exempts a flat amount of the value of a property from taxation. Most states provide such exemptions for owner-occupied homes, but the exemptions vary greatly in size and sometimes are restricted to particular groups of homeowners, such as the elderly or veterans. Since homestead exemptions are a flat amount, they relieve a higher percentage of property taxes for middle-income taxpayers with more modest homes than for high-income taxpayers with large homes. Unlike a circuit breaker financed from state revenues, a homestead exemption reduces the revenue available to a locality to finance schools and other public services, but it's better targeted to needy taxpayers than a property tax limit.

States Can Relieve Pressure on Property Taxes

States can couple eliminating or reforming property tax limits with actions to avoid unwarranted increases in property taxes, or in some cases to reduce those taxes States can increase income taxes, especially for high-income residents who have gained the most from rising inequality. Other options include adopting or expanding state inheritance and estate taxes, which typically are paid by the very

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[44] Institute on Taxation and Economic Policy, "Property Tax Circuit Breakers in 2017," September 11, 2017, https://itep.org/property-tax-circuit-breakers-in-2017/.

wealthy; closing loopholes that allow profitable corporations to avoid taxes; and other steps that ask the wealthy to contribute at least as much of their income in state and local taxes as middle- and low-income families. (The bottom fifth of households pay 10.9 percent of their incomes in state and local taxes, according to the Institute on Taxation and Economic Policy, double the 5.4 percent figure for the top 1 percent of households.)[45] The additional state revenue could be used to restore cuts in state aid to localities and for future increases in state support for education and other local services.

As noted, federal aid to localities has dropped precipitously since the late 1970s, and the Trump Administration and Republican congressional leaders have proposed additional cuts in areas including education, policing, environmental efforts, and infrastructure. The federal government could relieve pressure on property taxes by increasing, rather than cutting, aid to localities for these types of services and investments.

Conclusion

Each of the four states that this report examines — Michigan, Massachusetts, New York, and Oregon — designed its property tax limit differently, but the limits in all four states have had adverse consequences for quality of life and creating broadly shared prosperity. The limits have forced cuts in critical services and increased inequality.

Most property tax limits were enacted 20 years ago or more. Today's fiscal climate for state and local governments is very different: federal and state aid to localities has declined over time, making localities more reliant on their own-source revenues, and many states are grappling with structural weaknesses in their revenue systems that leave them unable to raise enough revenue over time to cover existing services, which could lead to further cuts to aid for localities. A new round of cuts in federal grants to states and localities could well occur as well.

For all these reasons, it is time for states to repeal or relax existing property tax limits in order to enable localities to afford the services that their residents expect and need. And it would be a mistake for any state to enact additional property tax limits now.

[45] Institute on Taxation and Economic Policy, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States," January 2015, https://itep.org/wp-content/uploads/whopaysreport.pdf.

Appendix

State Property Tax Limits

State	Rate Limit	Levy Limit	Assessment Limit
Alabama	X		
Alaska	X[1]	X	
Arizona	X	X	X
Arkansas	X	X	X
California	X		X
Colorado	X	X	
Connecticut			
Delaware		X[2]	
District of Columbia	X[3]	X[4]	X
Florida	X	X	X[5]
Georgia	X[6]		X (L)
Hawaii			
Idaho	X	X	
Illinois	X	X[7] (L)	
Indiana	X	X	
Iowa	X		X
Kansas		X	
Kentucky	X	X	
Louisiana	X[8]	X	
Maine [9]		X	X
Maryland			X
Massachusetts		X	
Michigan	X	X	X
Minnesota			
Mississippi		X	
Missouri	X	X	
Montana	X	X	
Nebraska	X	X[10] (L)	
Nevada [11]	X	X	
New Hampshire			
New Jersey		X	
New Mexico	X	X	X
New York		X[12]	X[13]
North Carolina	X		
North Dakota	X		
Ohio	X	X[14]	
Oklahoma	X		X
Oregon	X		X
Pennsylvania	X[15]	X	

State Property Tax Limits

State	Rate Limit	Levy Limit	Assessment Limit
Rhode Island		X	
South Carolina	X		X
South Dakota	X	X	
Tennessee			
Texas	X	X	X
Utah	X	X	
Vermont			
Virginia		X	
Washington	X	X	
West Virginia	X	X	
Wisconsin		X	
Wyoming	X		

Rate Limit: A legal limit on property tax rates so that they are either frozen or tied to an index or formula.
Levy Limit: A legal limit on the amount of revenue raised by the property tax or on the rate of growth in property tax revenues.
Assessment Limit: A legal limit on annual increases in assessed values that either freezes such values or ties such increases to an index or formula.
(L) denotes a limit that local jurisdictions may adopt if they elect to do so.

Notes:

1. Alaska's rate limit applies only to first- and second-class cities.
2. Delaware's levy limit is only in effect for the year following a total reassessment.
3. Washington, D.C.'s rate limit applies only to class 3 commercial and class 4 vacant property.
4. Washington, D.C.'s levy limit applies only to class 1 and 2 residential property.
5. Florida's assessment limit excludes school district taxes for non-homestead property.
6. Georgia's rate limit applies only to some school districts.
7. Illinois' levy limit applies to Cook County and the surrounding five collar counties. The limit is a local option for counties in the rest of the state and applies to non-home-rule taxing districts in counties that adopt the ordinance. It has been adopted by 33 other counties.
8. Louisiana's rate limit contains different limits from the rest of the state for certain types of municipalities, some parishes, and the school board of Orleans Parish.
9. Maine's levy limit applies to municipalities; the assessment limit applies to counties.
10. Nebraska's levy limits are adopted locally and are temporary in nature.
11. Nevada also limits the annual increase in property taxes for individual properties.
12. New York's limits on levy growth do not apply to the school districts of Albany, Buffalo, Rochester, or Syracuse. New York City has a separate levy limit from the rest of the state.
13. New York's assessment limit for residential property is in effect in New York City and Nassau County.
14. Ohio's levy limit applies to the amount of revenue collected from millage rates that exceed the statutory rate limit of 10 mills.
15. Pennsylvania's rate limit does not apply to Philadelphia, Pittsburgh, Scranton, the Philadelphia School District, or any jurisdictions with home rule charter.

Source: CBPP analysis of individual state statutes, supported by Significant Features of the Property Tax http://datatoolkits.lincolninst.edu/subcenters/significant-features-property-tax/Report_Tax_Limits.aspx, Lincoln Institute of Land Policy and George Washington institute of Public Policy