

THE PROPERTY TAX AND METROPOLITAN DISUNITY

THE PAST AND FUTURE OF THE PROPERTY TAX

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The main property tax defects related to their wise use in metropolitan development are three in number:

1. The property tax rate is not uniform throughout the state.
2. The base of the property tax is not limited to the value of land.
3. Public school support provided by the property tax is locally determined and administered.

The undesirable effects of each of these weaknesses is so great that each justified our serious consideration here in an analysis of metropolitan disunity and the identification of ways to reduce it.

History in Brief

The historical background of the US property tax that spread throughout the nation is fairly well established. The tax was not used except as a tax on particular items until the 1820-40 period. When the national government took over the monopoly of customs collections in 1789 with the adoption of the federal constitution, the colonies, now states, began to look for substitute revenues. The levy of a tax on a list of things, just as customs duties are levied on a list of imports, was turned to as a revenue source. By the 1820's the list had begun to develop into a general percentage levy on the value of land and in some cases all property. From 1840 to 1860 the general ad valorem property tax moved from state legislation to state constitutions, and the breadth of coverage increased.

The tax grew as a local tax source and as a state tax source. The tax turned out to be the revenue source local governments turned to after the Civil War as free universal education was introduced with a very large portion of the financing placed on local government units--the school districts. The other large area of government expenditure growth--long distance highways for autos--became a state financial project. The states--following the lead of Oregon in 1919--turned to a special excise tax on gasoline and did not exercise their property tax powers to finance this government service expansion.

The general ad valorem property tax, possessing a basic core of uniformity but with certainly as many variations as there were states and to a degree as many variations as taxing districts, became in this unique sense a nation-wide American institution by 1890.

Also, in the year 1890, the American Economic Association published History of the New York Property Tax by John Christopher Schwab.¹ The study, in looking toward reform, recommends a reduction in the functions of the state in the administration of the property tax. Hopefully, weaknesses apparent in state use of the property tax would be corrected if the tax were entirely administered by local officials and all the funds were used to finance local government services.

State legislation and constitutional provisions of the 19th Century provided for the financing of state activities by millage levies on the assessed value of properties. The values were to be determined under state laws by elected county and township officials. The revenue demands of the local governments expanded much more rapidly than those of the state. For example, in Ohio state taxes increased by 165% between 1846 and 1859 and during the same period local taxes increased by 329%.² The need for local revenues moved the property tax away from the state level toward local government at this early date. The trend continued and finally resulted in the existing situation where the general ad valorem property tax is a very minor source of state tax receipts.

Independent Sources

By the 1880's the older states such as New York were busy developing state revenue sources independent of the property tax. The business corporations were the first economic institutions to be identified as independent state tax sources. State inheritance taxes came along at about the same time.³ The general attitude seemed to be that the need for additional revenues of local governments should take precedence over state government expanding revenue requirements in tapping the ad valorem property tax base.

The pressures for spending between 1870 and 1914 and the closeness of the services to be provided by this spending to the local community, created the appropriate environment for the property tax to move toward local governments and away from the state. The changes recommended to accommodate the fiscal requirements were called "segregation."

Segregation, which was first recommended in 1886 in Illinois, provided for the abandonment of the property tax as a source of state revenues. The advocates felt that the state revenue needs could be met by a group of indirect taxes.

Segregation recommended separation of the tax sources used by state governments. It was a policy recommendation attempting to do for state and local governments what then existed between the federal government and state governments.

The program was recommended by tax reformists as a method of improving the property tax.⁴

A nexus was forming during the last twenty years of the 19th Century and the first twenty years of the 20th Century leading to a basic change in the fiscal systems of state and local governments. The property tax was no longer to be a basic concern of the state government. The states were going to develop indirect taxes and use their power of incorporation to meet their revenue needs.

Assumptions of the Times

All of the discussions of the period assumed the expenditures best carried out by state versus local government would remain as they were at the turn of the

century. It was also taken for granted that the expenditures administered by each level of government would also be financed by taxes administered by that level of government.

Neither the idea of grants-in-aid between state and local governments nor the distribution for local government use of state collected revenues entered significantly into the considerations. It was assumed that education, the major growing expenditure, would remain firmly rooted in the local government as would road construction and maintenance. Higher education was largely supported by the private economy with the state area limited to teachers colleges and federally assisted land-grant colleges.

This was the situation as the economy and the American society moved placidly along from 1910 to 1930 with some frivolity and violence induced by war and prohibition. Then came the sharp deflation of 1933 and the property tax frequently could not meet local expenditure requirements. The state developed retail sales taxes and increased the productivity of personal income taxes and corporation taxes to acquire funds for grants to help in the financing of primary and secondary education. In 1932, .5% of state revenues came from a general retail sales tax; and in 1956, some 23% came from this source.⁵

Not Basically Stable

The property tax which had gradually become only a local government tax proved in the depression 30's not to have the basic revenue stability tax theorists had identified as one of its few good basic characteristics.⁶ Jensen, writing in the late 1920's, took the regular collection of property taxes as being assured and discussed delinquency only as the result of economic decadence of a limited area, taxpayer carelessness, bad tax collection procedures or unrealistic expenditure programs.⁷ The vital importance to the performance of local government services of regular collection of the assessed amounts was recognized by Jensen and he wrote "that if a cog slips in the machinery and the assessment or the collection or both are delayed, the situation becomes extremely critical."⁸ He did not visualize many of the cogs being frozen through severe and continuing deflation. The types of pressures resulting in sharp reduction of property tax collections from 1932 to 1937 were not considered in Jensen's very careful analysis of the tax.

The deflation crisis of the 1930's increased the rapidity of progress toward separate taxes for state use and administration. State aid to local school districts was the largely new element that developed at this time. It was introduced first in only a few states as a temporary procedure, but rapidly became more widespread and turned out to be very permanent indeed.

The Property Tax Today

The property tax today is only a very minor source of state revenues. Most of the collections for state use arise in New Jersey, Nebraska, and Montana with scattered amounts in other states largely from the application of property taxes to public utilities. It is calculated that property taxes going to state governments amount to somewhat more than 3% of collections and provide states with somewhat less than 3% of the revenues they collect from their own sources.⁹

Today the property tax is nearly exclusively a local government revenue source providing some 88% of the tax revenues of these governments. In Ohio the

property tax became nearly completely a local tax source as early as 1902.¹⁰ It is also true local governments spend nearly half of their tax collections for education. Therefore, the support of education absorbs about one-half of the property tax collections.¹¹

The current situation of state aids in large amounts and the possibility of efficient state-wide property tax assessment and record keeping make a return to state use of the property tax appropriate. It is known now that many local government subdivisions have arisen to avoid payment of taxes on valuable properties.

The development of tax havens has balkanized municipal and suburban planning. Also, the competition of small subdivisions to attract industry to create what is called economic balance thwarts all efforts to develop broad soundly based land use arrangements.

Current Conditions Call for State Tax

A uniform state-wide property tax with revenues available to local school districts is the approach that best fits current conditions. (Local governments could continue to use the property base developed by the state to apply millage rates to support a school system above the one provided by state and federal funds and to support local government functions.)

The limitation of the property tax base to land is necessary to eliminate senseless competition for industrial and commercial properties. If buildings and personal property are a portion of the property tax base, they can provide a revenue surplus that can be distributed and used by deficit areas.

Land value taxation brings property taxation back to the sound equity base understood by many but seldom carefully identified. Briefly, it is that the property tax can only be a just tax if it is levied on values not created directly by an individual but on a principal heritage of all the people--the land.

Collection Comparisons

It is sometimes stated on the basis of wealth data that to collect in property taxes limited to land values what is now collected at the effective 1.4% rate on all taxable non-farm realty would require a tax rate equal to all land rent. Calculations in California by Ronald Welch present a much different situation. His data indicate the required rate would only have to be about 2.2%. A British study also shows "rateable values exceeded site values by only 13%."¹²

If the relationship of land value to total real estate value that seems to exist in California is the general situation, and assuming that 50% of property tax collections are used to provide basic public school support, a state land value tax of 1.1% would be adequate to permit the state to take over the school district's use of the property tax.

Under this sort of arrangement, local governments, for purposes other than education, could utilize the conventional property tax base. To a considerable extent the collections would be used to finance expenditures for roads, fire and police protection; expenditures directly benefiting property improvements.

Research Needed

Additional research in the United States is needed to determine what tax rate would be required to produce the revenues now made available by the property tax for public education if equal state taxation of land values throughout the state was initiated to bring in the funds. The first state to introduce these two reforms: (a) state-wide property taxation, (b) the use of only land as the property tax base will be able to make several strides toward solving the basic vexing problems of regional planning and industry attraction, and education financing.

The introduction of a state land value tax to support public education would permit all local governments to sharply cut ad valorem property tax rates on buildings and personal property. As a result, the economic pressures to establish and continue uneconomic local government units would be sharply reduced. It would make the separate incorporation of wealthy communities to "insulate themselves from payment of a proportionate share of the property taxes,"¹³ much less attractive. It would encourage construction and attract industry to the state, for land values would tend to be reduced and the tax levied on newly constructed buildings would be sharply reduced.

The increase in the portion of property taxes resting on land values and the administration of the tax on a state-wide basis at a uniform rate would definitely place the property tax on the side of metropolitan unity instead of disunity as is now the case. In addition, the property tax would return as a state revenue source where it was a hundred years ago. This time, however, the administration of assessments would be in the hands of state or state controlled officials rather than independent local government elected assessors.