Incentive Taxation

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REFORMING THE PROPERTY TAX FOR HEALTHIER COMMUNITIES

U.S. taxpayers seriously oppose inequities of our nation's traditional tax structure and we are experiencing a growing revolt against "the property tax."

The Center for the Study of Economics has conducted extensive research on the property tax and has consulted with many community leaders and elected officials on how to raise revenue in ways that are equitable and constructive. Raising enough revenue to pay for the replacement of infrastructure and to deliver basic social services challenges local officials less able to rely on state and/or federal aid. The general strategy has been to create new methods of taxation and to increase the tax rates on all forms of personal and business assets, on commerce, and to increase fees for various services. For some communities this has resulted in greater revenue without driving people and businesses away; for many other communities, their tax base has continued to decline as those in a position to leave do so.

Our research into the effects of taxation on local communities and regional economies supports the need in many cases to restructure the means by which revenue is raised. Whether revenue is dedicated to pay for public education or other public goods and services is an important, but secondary, consideration.

What a community offers to its residents, businesses, and other entities are locations on which to live and engage in commerce. The quality of infrastructure, amenities, and services provided to these locations by the community are converted by market forces into "land value." Logically, then, land value ought to be treated as the primary fund upon which the community draws its revenue. Most communities, however, capture only a small portion of this fund. Instead, most of the revenue raised via the property tax is raised by taxing the value of buildings. The result is that the construction of new buildings and the maintenance and renovation of existing structures is penalized rather than encouraged.

Today's property tax (actually two taxes with very different effects) captures most of its revenue by taxing the value of buildings (which individuals create), rather than the value locations (which the community as a whole creates). The result is that owners who speculate or under use prime sites are handed an unfair tax break. Owners who maintain old buildings and put up new ones have their taxes increased.

To correct these backward incentives - and to improve fairness - some local governments do not tax buildings at all; some tax improvements much less than land. Every jurisdiction that has shifted its property tax off buildings, onto locations, has benefited.

Owners of residential property tend to have more value in their homes than in the land on which the home is built. Across many communities and states, 75-80 percent of all homeowners experience a reduction in their property taxes when the property tax has been restructured to shift the burden from buildings to land. Most commercial and retail property owners also save. It is owners of vacant lots and underdeveloped sites who pay more, which helps spur them to improve their sites or sell to someone who will make such an investment.

Moving to land value taxation will impact some homeowners who live in neighborhoods with high land values but who are on fixed incomes. Communities sensitive to the benefits of maintaining the character and diversity of neighborhoods can permit homeowners to petition to have their annual property tax payment capped based on a formula tied to household income, with the unpaid tax obligation accruing as a lien against the property to be paid upon sale or transfer of title. In this way, equity is established while recognizing the importance to many people of being able to remain in their home after their working years have ended.

Another option is to exempt property values up to some amount from the tax base. For example, if the median assessed land value for owner-occupied residential properties is $20,000, only the assessed value above $20,000 would be subject to the property tax. Once the community has fully reached land value taxation, the result would be to exempt those with the lowest property (i.e., land) values in the community from the property tax.

As briefly mentioned above, whether and to what extent our publicly-funded schools should receive most or all funding from state government is a separate question from how revenue is raised. To some extent, land values in every community are influenced by the investments made by the state (and federal) government in highways, bridges, mass transit, police protection, and other services. A statewide surtax applied to assessed land values, with the revenue dedicated to public schools, is one way to capture these values and return them to communities based on student enrollments or need.

Land value taxation meets the three essential tests for true tax reform: fairness, equity, and simplicity. Join us in putting this essential measure before voters and our elected representatives.

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