



A Look at the Property Tax

Property taxes are often vilified as the cause of grandmothers being tossed out of their homes. Such rhetoric focuses on the lack of connection, in certain instances, of property taxes to a family's ability to pay those taxes. Rather than trying to target relief to those who are truly overburdened, though, recent property tax relief proposals in Georgia offer blanket fixes – ones that reach you, me, grandma, and Ted Turner.

With every tax, there are positives and negatives, and a healthy dose of disdain. While property taxes are one of the most disliked taxes and do suffer from the somewhat tenuous link to one's ability to pay, there are several positive aspects to the tax. Lawmakers who are considering a swap of property taxes for more sales taxes, as proposed in House Resolution 900, should carefully weigh the benefits and drawbacks of the property tax before enacting blanket fixes.

Property taxes are an important source of stability in our tax system. All states tax property, and with good reason. Property taxes are more stable than sales and income taxes.³ When funding the most critical services, such as education, stability is crucial.

Property taxes have high collectability. According to GSU's Fiscal Research Center, the collection of property taxes levied "is very high. Generally, 94 percent to 98 percent of the property tax levy is collected on time; probably 99 percent or more is ultimately collected."⁴

Property taxes are fairer than sales taxes. While both the property tax and sales tax are regressive, taking a higher percent of income from middle and lower income households, the property tax is less so.⁵ Sales taxes are the most regressive tax, since middle and low income households consume a much greater share of their income on taxable items than higher income households do. Moving from a property tax to an increased sales tax is a tax shift from higher income households to middle and lower income households.

HR 900 Synopsis

- Eliminates education property taxes for owner-occupied residential property
- Eliminates ad valorem taxes on personal motor vehicles
- Creates a refundable income tax credit for low-income Georgians
- Replaces property tax revenues with:
 - state sales tax on consumer services, lottery tickets, and groceries
 - \$20 state fee on personal motor vehicles
- Distributes new sales tax revenue back to school districts based on amount they would have raised from the property tax on homesteads¹

Homeowners' Property Taxes

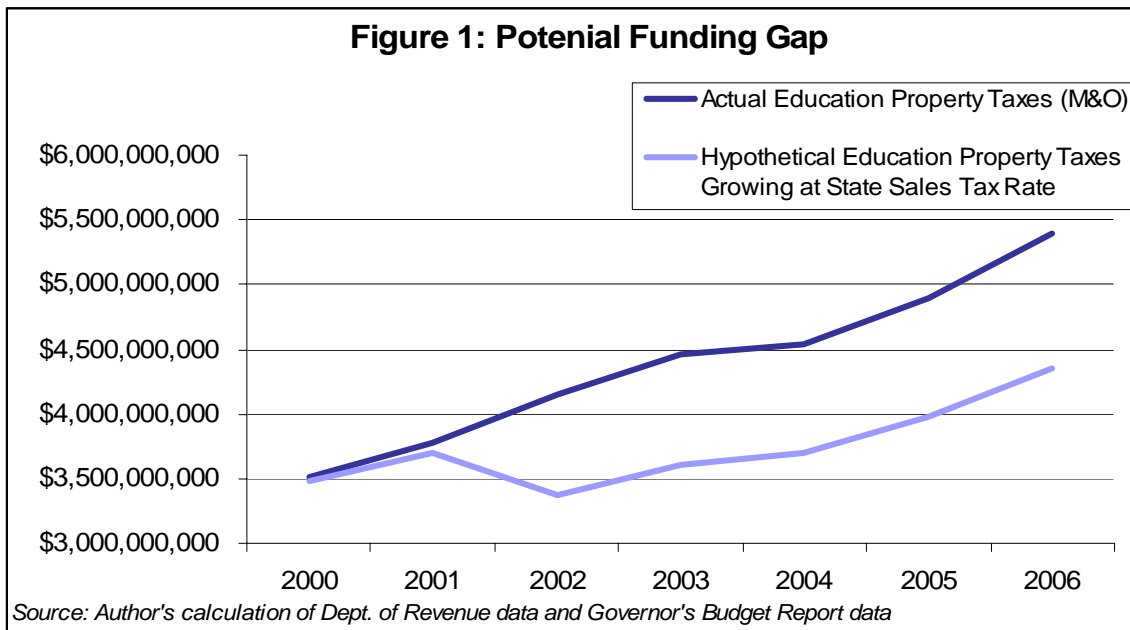
- Among homeowners only, Georgia ranked 38th in median property taxes as a percent of personal income in 2005. The median property tax burden for homeowners in Georgia was 1.8 percent of income.²
- For homeowners age 65 and over, Georgia ranked 41st in median property taxes as a percent of personal income in 2005.

Property taxes can offer a *balance* between households and businesses. Local services benefit households and businesses alike. While households gain from educational opportunities, safe communities, recreational spaces, and more, businesses benefit from well-maintained roads for commerce, an educated workforce, and other local public services. The property tax allows both households and businesses to contribute to the cost of these local services.

Property taxes are *transparent*. Property owners know their total property tax bill, as the bill comes in the mail. This transparency allows property owners to fully understand their contribution to local public services and better hold their local elected officials accountable for those services.⁶ In comparison to the property tax, the sales tax is much less transparent. Few residents know their total state and local sales tax bill, since they pay the sales tax a penny at a time.

Property taxes can provide *adequate* funding for local services, such as public safety and education. Local leaders set the millage rate to raise the amount of revenue needed for local public services. If a community needs four new firemen, local officials have the ability to raise the millage rate and bring in the needed property tax dollars. The flexibility of the property tax to meet the needs of a community is especially important when state aid decreases. After the 2001 recession, for example, state funding for education declined due to a drop in state revenues. Certain localities were able to raise property taxes to fill that gap in education funding.

If policymakers decide to replace education property taxes with an expanded sales tax, they will need to be certain the sales tax has the strength for the job. Over the last few years, sales tax growth has lagged education property tax growth. From 1999 through 2006, state sales tax growth has fallen behind education property tax growth every year except one.⁷ Using this historical growth as an illustration of the possible effects of a tax swap, the potential gap in education funding is readily apparent (Figure 1). If education maintenance and operations property taxes grew at the sales tax growth rate from 1999 to 2006 (illustrated by lighter line), Georgia schools would have had \$1 billion less in revenues than they actually had in 2006. The main determinant of that gap would have been the 2001 recession, which devastated sales tax growth, but did not impact property tax growth. Expanding the sales tax base to cover services, as proposed in HR 900, should give added stability to the sales tax, but will it be enough? Lawmakers need to conduct a careful analysis of this question before pursuing this type of scheme.



Property taxes add *diversity* to the tax system. All of the attributes reviewed above do not mean that the property tax is perfect and the sales tax not. On the contrary, each tax has its benefits and drawbacks. A diversified state and local tax system, one with income, sales, property, and other taxes and fees, offers the benefits of those taxes while lessening the costs associated with each. For example, the income tax, which is the one progressive tax, works to offset the unfair nature of the sales and property tax.

The property tax adds to the diversity of the tax system, so that state and local governments do not need to rely on any one tax to a detrimental degree. A lack of diversity can lead to instability, as well as a drop in bond ratings. Each state receives bond ratings based on how market analysts view its finances. For over 30 years, Georgia has maintained an Aaa bond rating from Moody's and was one of only seven states with that top rating in 2006.⁸ This top bond rating allows Georgia to borrow money at a lower cost. According to Moody's methodology, revenue diversity is one of the many variables used to determine a state's bond rating.⁹ While numerous economic and demographic conditions, in addition to the tax structure, influence the ratings, lawmakers would need to seriously consider whether placing more reliance on the sales tax would jeopardize our good financial status among states. Georgia's leadership would be well served to discuss any such proposal with market analysts to gauge its effects on our credit rating.

Property taxes are *deductible* from federal income taxes. When itemizing on federal income taxes, Georgians can deduct the property taxes they paid to state and local governments. Reducing property taxes would cause a loss of a certain amount of that federal deduction.

The Main Negative – Property taxes do not always reflect *ability to pay*. This is the negative side of property taxes, the side that often overshadows the many positive aspects of the tax. Property taxes are fairer than sales taxes across income groups, but they are not always related to ability to pay. In neighborhoods with rising home prices, a family might purchase a home with manageable property taxes, only to see those taxes outpace income growth. While this negative aspect of property taxes exists, a solution also exists. Property tax circuit breakers work to keep property taxes within a reasonable level for homeowners and renters who are at risk of being overburdened. A 3 percent circuit breaker, for example, would mean that a resident under a certain income level would be reimbursed by the state for any property taxes paid that are over 3 percent of his income. A majority of states have such relief programs.

South Carolina: A Case Study

In 2006, the South Carolina Legislature passed Act 388, which replaced homeowners' property taxes for education operations with a higher sales tax. The state sales tax rate increased from 5 cents to 6 cents in July 2007, while the sales tax on groceries was reduced to 3 cents in October 2006.¹⁰ The new sales tax revenue from the additional penny will be placed in the Homestead Exemption Fund (HEF). In the first year, 2007-2008, school districts will be reimbursed from the HEF for the lost property taxes based on their property tax digest. In subsequent years, each school district will receive a share of the HEF based on a weighted pupil count. The total HEF will only be allowed to grow by population growth plus inflation.¹¹ Companion legislation also placed caps and other restrictions on local governments.

While HR 900 would increase the sales tax in a different way than South Carolina's Act 388 (a tax base expansion rather than a tax rate increase), the similarities between the two proposals are noteworthy. Both remove the property tax for education, thus placing more responsibility for the funding of education at the state-level. Both remove the property taxes on homeowners only, thus affecting the balance between household and business property tax contribution. Any future property tax increases for education will fall solely on businesses and renters.¹² Both expand the reliance on sales taxes, thus shifting the tax burden to lower and middle income households.

With the similarities between Georgia's HR 900 and South Carolina's Act 388, it is appropriate for Georgia legislators to examine the experience in South Carolina before moving forward with HR 900. While the full effects of Act 388 are not yet felt given its newness, there are several unintended consequences related to school finances that are already coming to light. The final report from the Task Force on Funding for World Class Learning, a task force convened by South Carolina's State Superintendent of Education, noted in December 2007:

"Act 388, which drastically reduced the most stable source of funding for education and replaced it with an increase in the state sales tax, has created a number of adverse consequences for schools and districts, particularly in high-growth areas. The Task Force on Funding for World Class Learning shares the view of many state leaders who believe that comprehensive reform of South Carolina's tax system is needed to create a system that is equitable, adequate, stable, and sustainable."¹³

The Task Force recommended several short-term adjustments the legislature should make in the upcoming legislative session to alleviate some of the unintended consequences.

A new funding organism has been created out of the political process of South Carolina's legislature. Will it be productive for the state's education system, or will it prove to be a Frankenstein-like experiment that wreaks havoc on South Carolina schools and taxpayers by:

- severely shifting the property tax burden to businesses and renters,
- harming education financing overall or in certain school districts, or
- overburdening renters and low-income residents.

South Carolina will work this session, and perhaps future sessions, to adjust the new system. Georgia legislators need to conduct a careful study of the South Carolina experience in this first year and in the coming years to judge whether Georgia's education funding should follow this path.

Conclusion

In commenting on South Carolina's Act 388, which took similar action to Georgia's proposed HR 900, Clemson University alumni professor of economics Holley Ulbrich stated:

"I'm not a big fan of raising sales taxes for a lot of reasons...But even if we do decide to raise the sales tax, we only get one shot at it. We had better decide what is the most important issue facing the state and use the higher sales tax to address that issue...We have a shotgun with only one bullet, and we have to decide what the real monster is, the greatest threat to our future as a state, and use that bullet on that target."¹⁴

Georgia faces the same situation. If we are going to use our once-a-generation tax reform opportunity, we better make sure it is focused on the most pressing matters. Is property tax relief for all homeowners, regardless of income or means, the "real monster"? Or is the need for reservoirs more vital to the health of our state? Or perhaps the transportation or education financing needs are more critical? As Ulbrich noted, we need to use our one bullet wisely. A thoughtful, thorough analysis of revenue streams, the budget, and long-term goals for the state should occur before we shoot.

Endnotes

¹ *Property Tax Relief and The GREAT Plan*. PowerPoint presentation. <http://www.thegreatplanforgeorgia.com/>.

² Baer, David. *State and Local Property Tax Burdens in 2005*. AARP Public Policy Institute. May 2007. No. 2007-9.

³ Winters, John. *Tax Revenue Stability of Replacing Property Tax with a Sales Tax*. Georgia State University, Fiscal Research Center Report No. 164. September 2007.

⁴ Alm, James, et. al. *Tax Collectability and Tax Compliance in Georgia*. September 2006. No. 133. Georgia State University, Fiscal Research Center. <http://aysps.gsu.edu/frc/files/report133.pdf>.

⁵ McIntyre, Robert et. al. *Who Pays: A Distributional Analysis of the Tax Systems in All 50 States*. 2nd Edition. January 2003. Institute on Taxation and Economic Policy.

⁶ Youngman, Joan and Reschovsky, Andrew. "The Strengths of the Property Tax." *Boston Globe*. Sept. 22, 2007. www.boston.com/news/globe/editorial_opinion/oped/articles/2007/09/22/the_strengths_of_the_property_tax/. (Note: Youngman and Reschovsky are fellows at the Lincoln Institute of Land Policy in Cambridge.)

⁷ Author's calculations using data from Georgia Department of Revenue's *Summary of Ad Valorem Taxes Levied in Georgia* and Governor's Budget Report.

⁸ "By the Numbers: Georgia's Fiscal Management." December 2005. No. 8. Georgia State University, Fiscal Research Center. http://frc.gsu.edu/frpnews/fiscalimpact/2005issues/georgia_fiscal_management.pdf; Kurtter, Robert. "Special Comment: 2006 State Debt Medians." Moody's Investors Services, Inc. April 2006.

⁹ Kurttner, Robert and Timothy Blake. "Rating Methodology: Moody's State Rating Methodology." Moody's Investors Services, Inc. November 2004. p. 6.

¹⁰ Saltzman, Ellen. *The South Carolina Tax Swap: The Estimated Impact of Act 388 on Homeowners and Renters*. July 20, 2006. Clemson University, Strom Thurmond Institute of Government and Public Affairs.

¹¹ Schunk, Donald. *South Carolina's Tax Changes: What They Will Mean?* B&E Review. Vol. 54, No. 1. <http://mooreschool.sc.edu/moore/research/Publications/BandE/bande54/54n1/taxchanges.html>.

¹² Ibid.

¹³ Task Force on Funding for World Class Learning. *Report of the Task Force for Funding on World Class Learning*. December 12, 2007. <http://ed.sc.gov/agency/divisions/fhr/Task-Force-on-Funding-for-World-Class-Learning.html>.

¹⁴ Ulbrich, Holley. *Framing the Property Tax Debate*. February 22, 2006. Speech at the Municipal Association of South Carolina's Hometown Legislative Action Day.

<http://www.masc.sc/resources/hlad%2006%20ulbrich%20keynote%20speech.pdf>.