

WHO PAYS PROPERTY TAXES? A LOOK AT THE EXCISE TAX EFFECTS OF PROPERTY TAXES ACROSS THE STATES

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INTRODUCTION

THERE ARE THREE BASIC VIEWS OF THE PROPERTY tax: the “old” view, the “benefit” view and the “new” view. Under the “old” view the property tax has two portions: a tax on land and a tax on structures. The land tax falls on landowners and the structure portion, assuming capital is mobile, falls on consumers of final goods, including homeowners, renters, and consumers of products (Wildasin 1986). Thus, the old view would produce a regressive tax as most of the burden would fall on consumers and low income people consume a larger proportion of their income. The benefits approach introduced by Hamilton (1975), which relies on the Tibeout (1956) model, suggests the property tax is a non-distorting payment for local public goods. The benefits approach suggests that the property tax is not actually a tax but acts like a user fee. In the “new” view, originated by Mieszkowski (1972), the property tax has two parts: the average nationwide rate, which falls on all owners of capital and the local differential rate, which has excise tax effects. Wildasin (1986) and Aaron (1975) present an extensive discussion of the old and new views.

The new view has some similarities to the corporate tax in that the corporate tax has a general tax on capital but excise tax effects on corporate and non-corporate goods. The average property tax portion in the “new” view is progressive as higher income individuals hold more capital. The incidence of the excise portion is uncertain since it depends on the relative incomes of consumers in the states with tax rates above and below the national average property tax rate. If the differentials in effective property tax rates are small then the tax is essentially a tax on capital for distributional purposes, generally viewed as progressive.

This paper will use new data on effective tax rates for all states to measure the average tax rate and standard deviations for assessing incidence

under the new view. These rates will also be tested against per-capita income to determine to the progressivity or regressivity of the excise tax effects, assuming consumers in each state tend to consume more of their own goods (certainly the case for housing and services).

DATA

The data set consists of effective property tax rates for 49 states and DC and variables that, according to the theories outlined previously, could explain variation in those rates across states for tax year 2000.¹ The effective property tax rates were determined by dividing state and local property tax collections from the Census State and Local Governments financial data by estimates of the 2000 market values of total property in each state.

Market values of states’ property were constructed from assessed values collected from states’ assessments, auditing, or tax departments. Further information was collected on the assessment ratios, by type of property when available, and timing of assessments. The assessed values were then inflated to market value using the assessment ratios and indexed to the year 2000 according to the assessment cycles. For further details on the assessment ratios and cycles see Gravelle (2008). Due to the complexities of Proposition 13 and its effect on California assessed values, three alternative methods for estimating California market values are used. The first, termed ratio, uses California’s State Board of Equalization estimated market values of commercial and industrial property to obtain an assessment ratio that is applied to total assessed property. The second, termed res, uses the average share of residential property across states that that broke out such data to inflate the estimated market value of commercial and industrial property to total property. The last, termed rule, relies on a “rule-of-thumb” assessment ratio of 60% assessment ratio suggested by officials in California’s State Board of Equalization.

*These views do not necessarily represent those of the Government Accountability Office.

INCIDENCE

Under the “new” view of property taxation, property taxes represent an average tax on capital as measured by the national average effective property tax rate. Deviations from the average represent excise taxes (or subsidies) on consumers. This view is similar to concepts applied to other forms of tax, such as the corporate tax, which is considered a general tax on capital but imposes excise tax effects on the consumption of corporate and noncorporate goods.² Because a tax on capital is generally assumed to be born by high income holders of capital, it is considered progressive. However, the incidence of the excise portion of the property tax depends on whether it is more often in the form of a tax or a subsidy and to a lesser extent where that tax or subsidy falls in relation of the general incomes of the state. This section will explore the value of the effective tax rates of property across the 50 states and DC and the implications deviations from the national average have on the incidence of the property tax as a whole.

The national, weighted average, effective property tax rate on total property is 1.51%, 1.43%, and 1.36%, including California using the residential share imputation, the commercial assessment ratio imputation, and the 60% assessment rule imputation, respectively. The national effective property tax rate on real property is higher by nature of the exclusion of the zero effective tax rate personal property inherent in the total property base values. The national effective real tax rate is 1.65%, 1.57%, and 1.49%, including California using the residential share imputation, the commercial assessment ratio imputation, and the 60% assessment rule imputation, respectively.

New Hampshire and New York have the highest and second highest effective tax rate, respectively, regardless of using real or total property. Hawaii and Alabama have the lowest and second lowest

effective tax rates, respectively, regardless of using real or total property. It is not the first time Hawaii has ranked low effective property tax rates. Lorrelli (2001), who published residential property tax rates in the largest city in each state for 1999, found that Honolulu ranked lowest in effective property tax rates compared to major cities in other states. Table 1 provides some descriptive statistics on states’ effective tax rates. For more details on the states’ effective tax rates see Gravelle (2008). Figures 1 and 2 show the distribution of total and real effective tax rates using the ratio estimation of California property values.

The remaining incidence analysis will focus on the total effective tax rate since, while it does have limitations in the exclusion of the zero rate on personal property, incidence of property taxes necessarily should consider total property. All the analysis will present the three methods of adjusting California values as there is no a priori belief about the best method to impute California values.

In determining the incidence of the property tax under the new view, it is important to remember that the analysis begins with the progressive nature of the tax of capital represented by the national average property tax. The incidence of the excise tax effects merely describes departures or enhancements of progressivity. The portion of the effective tax rates on property expressed as excise effects account for 29%, 34%, and 39%, under the residential share, commercial/industrial assessment ratio, and 60% assessment ratio imputed values of California, respectively. Half, in each case, is an excise subsidy and half a tax. These shares represent the property base weighted average of deviations for the national average effective property tax rate. That is, each share equals the absolute value of the difference between the state’s effective tax rate and the effective property tax rate for the entire nation multiplied by the share of the national property

Table 1
Descriptive Statistics of State’s Effective Tax Rates on Total and Real Property

	Total ETR CA res	Total ETR CA ratio	Total ETR CA rule	Real ETR CA res	Real ETR CA ratio	Real ETR CA rule
Mean (unweighted)	1.4522	1.4465	1.4431	1.5969	1.5910	1.5873
Standard Error	0.0735	0.0743	0.0749	0.0742	0.0751	0.0759
Median	1.4800	1.4800	1.4800	1.6800	1.6800	1.6800
Mode	1.9500	1.9500	1.9500	1.9400	1.9400	1.9400
Range	2.1800	2.1800	2.1800	2.1800	2.1800	2.1800
Minimum	0.5100	0.5100	0.5100	0.5100	0.5100	0.5100
Maximum	2.6900	2.6900	2.6900	2.6900	2.6900	2.6900

Figure 1: Distribution of Effective Tax Rates on Total Property (using ratio measure of CA property)

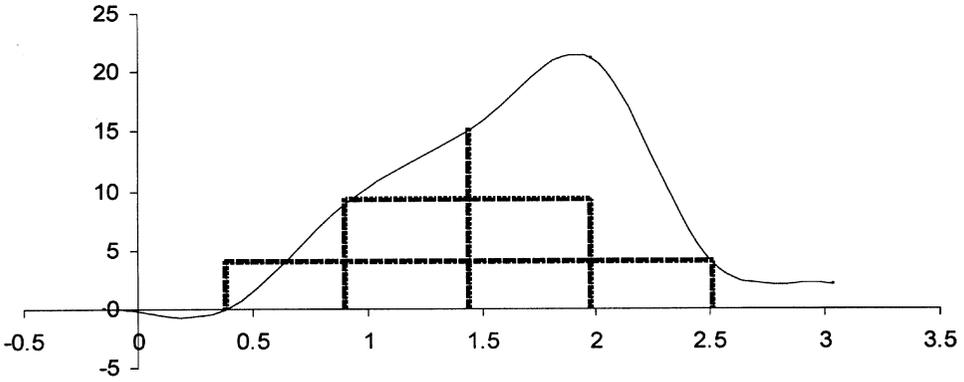
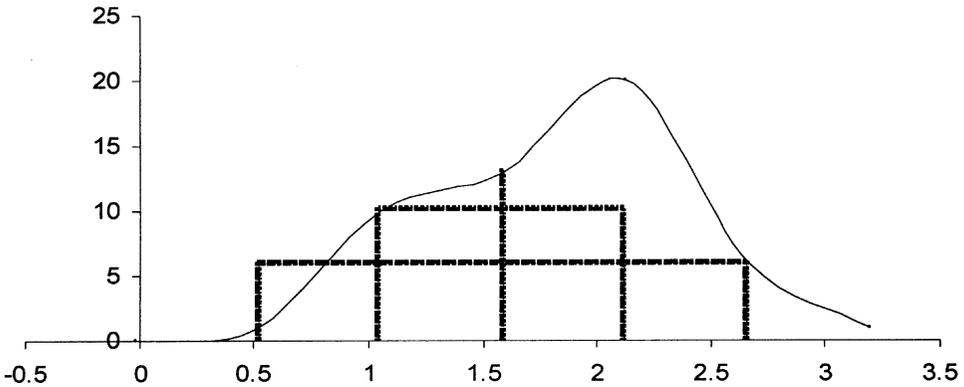


Figure 2: Distribution of Effective Tax Rates on Real Property (using ratio measure of CA property)



for each state divided by the national effective property tax rate. Therefore, these shares represent the portion of the property tax that is in the form of an excise subsidy or tax were the states to tax based on the national average tax rate. While the average excise effect is significant it represents less than half of the total incidence effect.

In general, based on the subsidy and tax excise shares for poor and rich states the excise effect of the property tax neither strongly increase nor decrease the progressivity of the property tax as a whole. Using the residential shares imputation for California, 48.7% of the excise subsidy is in poor states (states with per capita income lower than the national average) and 35.1% of the excise tax went to poor states. Under the commercial/industrial

assessment ratio imputation for California, 35.6% of the excise subsidy is in poor states (states with per capita income lower than the national average) and 37.6% of the excise tax went to poor states. If the “rule of thumb” assessment ratio of 60% was used to impute values for California, 26.5% of the excise subsidy is in poor states (states with per capita income lower than the national average) and 39.4% of the excise tax went to poor states. Depending on the different imputed values for California, 0.4% to 2.5% of the property tax is a tax on poor states or 2% is a subsidy for poor states. According to these results it appears that the excise tax effects do not significantly affect the incidence of the property tax. Whether these effects increase or decrease progressivity is uncertain; in fact the

results are clearly dependent on measuring property values in California. Nonetheless, the effect seems small. It seems clear that under the new view of property tax incidence it is fair to conclude that the property tax should be viewed simply as a tax on capital income.

CONCLUSION AND IMPLICATIONS

Under the new view, which claims that the property tax has two components—a tax on capital and an excise tax effect, the tax on capital is considered progressive and the incidence of the excise tax effect unknown. Using the shares of the excise tax afforded to the rich versus poor states the results are inconclusive as to whether the excise effect increase or decreases the progressivity of the property tax, fluctuating between generally subsidies in poor states and subsidies in rich states depending on estimated values of property in California. However, regardless of the uncertainty of the incidence direction, the net effect of the property tax on the poor barely reaches 2% of the tax as either a net tax on poor states or net subsidy for poor states, suggesting that the property tax can continue to be viewed as a general tax on capital.

The new view also describes these differential tax effects as arising from exogenous variations in effective tax rates that therefore contribute to the incidence of the property tax. Variations in the effective property tax rates may be very closely related to variations in the provision of services; much more so than taxes such as the corporate tax that have similar attributes to the new view of property tax. While this paper does not address the causes of variations in effective tax rates and potential goods it may fund, it may be worth noting how the net distributional effect of the property tax

when paired with benefits it provides could differ. If higher property taxes are due to demands for education, which Gravelle (2008) finds, than the extra revenue would likely be used to provide more public education. Since public education is more heavily consumed by lower income individuals, the net effect of regressive excise tax in states with higher effective property tax rates and lower per capita incomes could be mitigated, taking into account the benefits of the tax, by the increased provision of goods to the lower income.

Notes

- ¹ States vary in the definition of tax year; values are used as close to 1/1/2000 as possible. Therefore, 1999 data were used when assessment fell late in the year, for example, October assessment deadlines.
- ² Fullerton and Rogers (1993) assigned these excise effects in their distributional analysis of the corporate tax.

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