<u>DRAFT FOR DISCUSSION PURPOSES</u>

PROPERTY TAX RELIEF

<u>Background:</u> According to national polls, the property tax is one of the most unpopular taxes. Several factors contribute to its unpopularity in Washington and elsewhere:

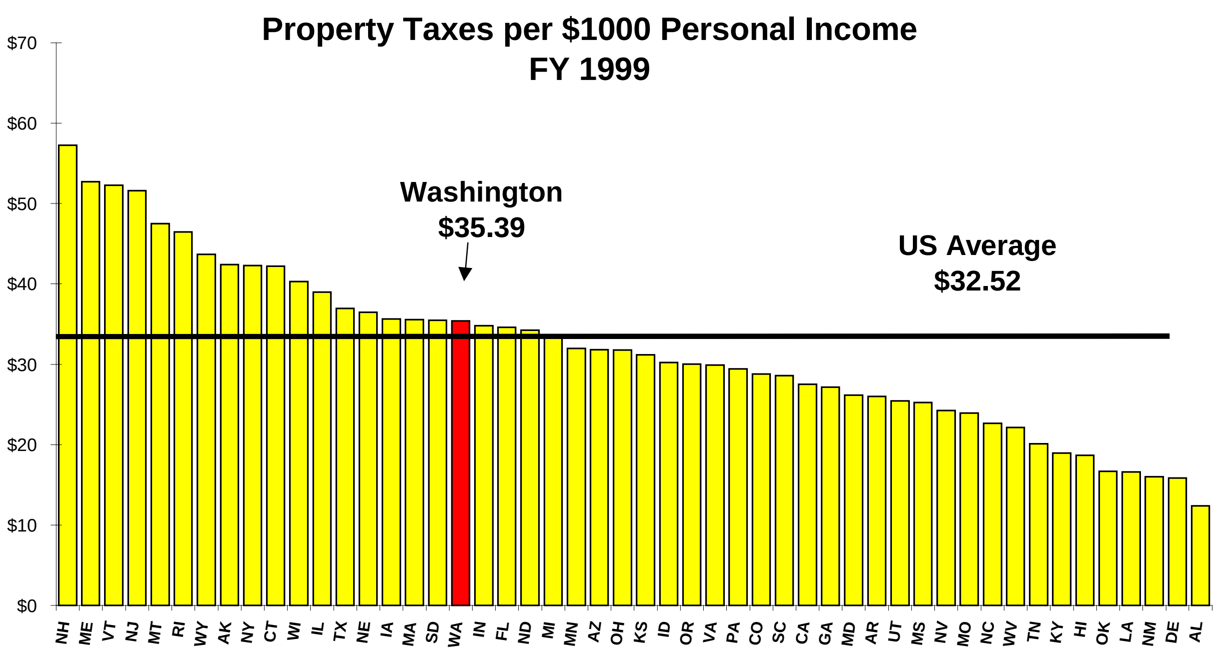
1. It is very visible, usually paid in one or two lump sums each year.

2. It is a tax on the assets you own, not on how much you consume (like a sales tax) or how much you earn (like an income tax). Financially comfortable families, struggling families, or retired couples in a neighborhood may pay the same amount of tax if the value of their property is the same, regardless of their ability to pay.

3. The value of your property, and the taxes you pay, are outside of your control, particularly if you live in a “hot” real estate market or if your neighborhood is in transition (i.e., changing from a residential area to one with mixed commercial or industrial uses).

4. Unique features of the property tax lend to the impression it is unevenly administered. The base of the sales tax is clear (the amount you paid for an item) and the tax rate is clear (i.e., on average 8.4 percent for all purchases). On the other hand the property tax is based on estimates of the value of all property and tax rates vary depending on where the property is located in relationship to more than 1,800 taxing districts in Washington.

Compared to other states, Washington’s property tax burden is slightly above average. Various property tax limits have kept the overall property tax burden moderate in relation to other states. These include the constitutional limit restricting regular levies to one percent of value, tax rate limits imposed on taxing districts, and the 101 percent limit restricting the amount regular tax levies can increase every year.



Washington's relative reliance on the property tax is also slightly above the national average. Property taxes account for about 32 percent of total state and local taxes combined. The property tax continues to be the predominant revenue source for public schools, fire protection, park and recreation, and other special purpose districts. However, the dominant revenue source for all state and local government is the sales tax.

Percentage of Reliance on Major State and Local Taxes Selected States - Fiscal Year 1999					
State	General Sales [1]	Selective Sales [2]	Property	Income	Other [3]
WASHINGTON	46.0%	13.1%	31.8%	----	9.1%
Oregon	----	9.8	30.0	47.3	12.9
Idaho		10.5	26.8	31.0	8.6
California	26.4	8.1	24.2	34.5	6.8
All States	24.6%	11.1%	29.4%	27.4%	7.5%

[1] Includes retail sales/use taxes and gross receipts (B&O) taxes.
[2] Includes taxes on specific items, e.g., gasoline, liquor, cigarettes and public utilities.
[3] Includes motor vehicle licenses and all other taxes.

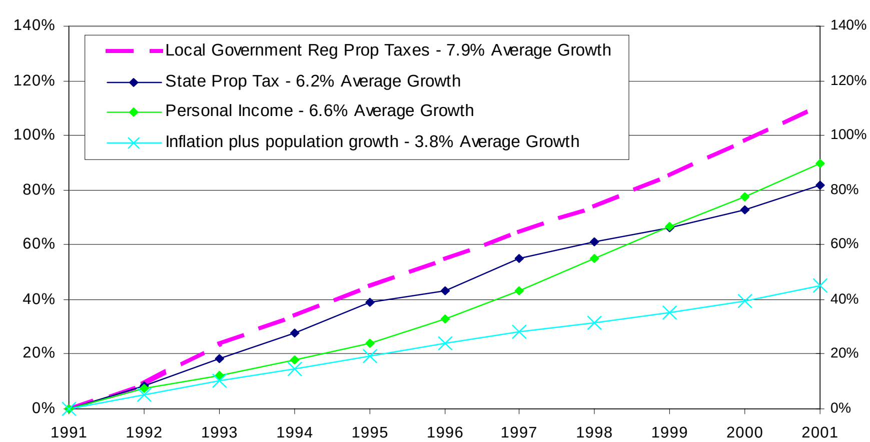
<u>Issue/Problem:</u>

Three recent trends help explain the heightened interest in some type of property tax relief:

1. <u>Increases in Property Values</u>. Since 1990, the assessed value of property has increased 220 percent statewide. Increases first hit King County (40 percent growth between 1990 and 1991), spread up and down the I-5 corridor, across the mountains to Spokane, the Tri-Cities, and Wenatchee and eventually to virtually all areas of the state. Some of the most spectacular increases have been experienced by waterfront properties or in rapidly growing areas.

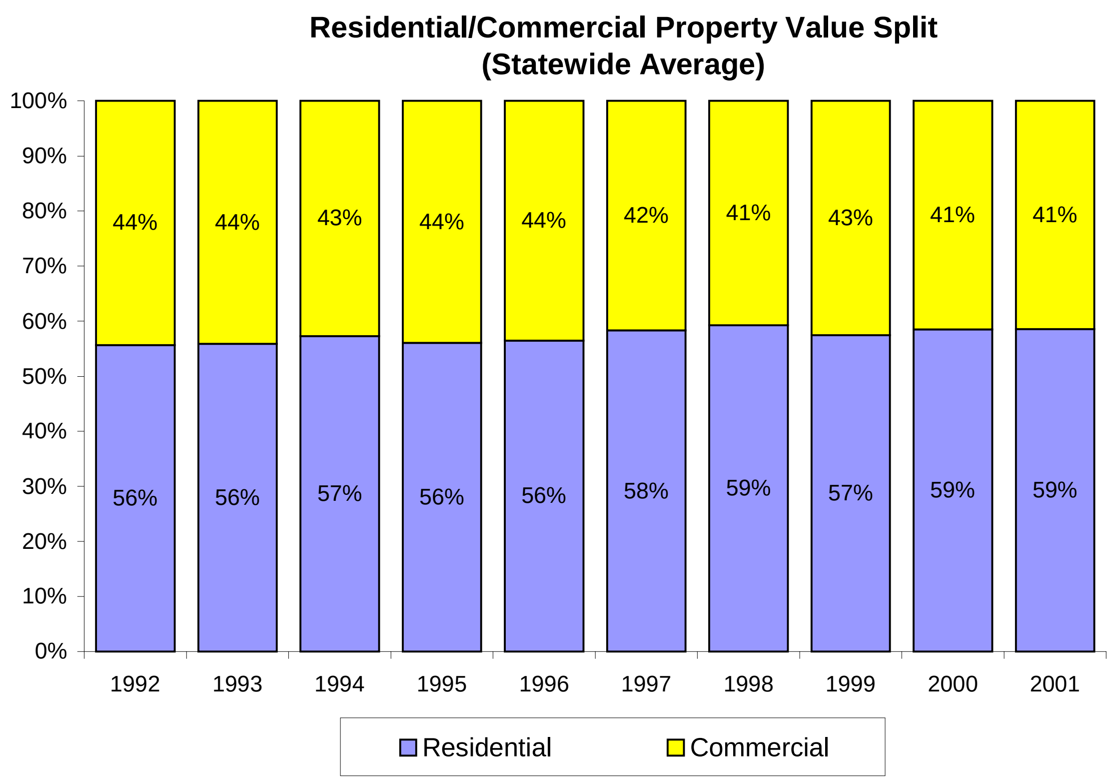
2. <u>Property Taxes Have Grown Faster Than Personal Income</u>. Recent growth in personal income has not kept pace with property tax increases in the last decade. The relationship between personal income and property taxes varies from county to county and, indeed, for every individual property

Growth Rates for State and Local Regular Property Taxes
1992 to 2001



owner depending on their circumstances. The most accentuated mismatch is illustrated by the example of the individual living on a modest, fixed income who has resided in a waterfront home for 35 years.

3. Distribution of the Property Tax Burden Has Shifted Towards Residential Property. The proportion of the property tax paid by residential property compared to commercial/industrial property has shifted from, a 56/44 percent split in 1992 to a 59/41 percent split in 2001. This has been caused by a booming real estate market that has driven up the value of residential property faster than commercial property and by a considerable amount or residential new construction.



Options/Alternatives:

Hundreds of variations of property tax relief have been proposed. There are four general categories that most proposals fall under.

1. Across-the-Board Reductions. These alternatives proportionately reduce the tax burden of all property taxpayers, residential and commercial, by directly or indirectly lowering levy rates. They generally respond to concerns that the overall property tax burden is too high or that governments rely too heavily on property taxes as a source of revenue. They do not shift taxes to other taxpayers, but they result in less revenue for taxing districts (Unless the revenue is replaced by some other revenue source). These alternatives do not require a constitutional amendment. Administratively, they are simple to implement.

- **State Levy Elimination** – One option is to eliminate the state school levy. The state levy rate is statutorily limited to $3.60 per $1,000 of assessed value but averaged $2.71 in 2001 because of the levy limits impose by Referendum 47 and Initiative 747.

2. <u>Valuation Growth Limits.</u> These alternatives place a limit on the assessed values of individual properties, or freeze or roll back assessed values. They generally respond to concerns that values and taxes are increasing too rapidly for certain properties and seek to provide certainty that taxes will grow excessively in response to market changes. These alternatives shift taxes from properties that are growing rapidly in value to those properties that are not. Some proposals allow property to be reassessed at market value when it is sold which has the effect of shifting taxes from long-term homeowners to new homeowners, or to those who move. These alternatives tend to result in less revenue for affected taxing districts, although they can have widely differing effects. Most alternatives probably require a constitutional amendment. Administratively, these alternatives tend to be somewhat complicated and expensive to administer.

    - **Property Value Growth Limit** – Under existing law, assessments are based on market value. This option would limit future annual growth in assessments to a fixed percentage. If the growth limit is set relatively high, most properties would eventually return to their market value (except in the face of long-term high growth). Some variations apply the limit to residential property only, or may require assessment at market value when the property is sold. California's Proposition Thirteen imposes a two percent per year valuation limitation and requires reassessment at market value upon the sale of the property.

    - **Property Value Freeze or Rollback** – These variations would freeze assessed values (either temporarily or permanently) or roll back valuations to a prior year.

    - **Phased-in Valuation Increases** – This option would require a large valuation increase to be phased in over a period of years rather than all at once. Thus, the taxpayer could adjust to and plan for the higher tax bill over a longer period of time.

3. <u>Homestead Exemptions and Residential Tax Credits.</u> These alternatives provide relief to homeowners only, usually by reducing the assessed valuation of owner-occupied homes by a flat amount or by providing a tax credit. They typically provide the same amount of relief to each homeowner irrespective of the value of their home. They generally respond to concerns that residential property taxes are too high or that the proportionate share of taxes paid by residential property is excessive. Homestead exemptions tend to shift the tax burden to business properties and some high-valued residential properties. Residential tax credits do not shift taxes (that is, other taxpayers do not end up paying more taxes – they just don't share in the benefit of the tax credit). These alternatives tend to result in less revenue for affected taxing districts, although they can have widely differing effects. Most alternatives probably require a constitutional amendment. Homestead exemptions tend to be moderately complicated and expensive to administer, and a residential tax credit less so. Thirty-seven states offer homestead exemptions or credits. Fourteen states have programs for senior citizens only, fourteen have programs with no age limits, and nine offer programs for all ages with more generous benefits for senior citizens.

    - **Homestead Exemptions** – This option reduces the assessed value of a homeowner's property, usually by a fixed amount (i.e., $25,000). Thus, rather than being assessed on a $100,000 home, the assessment would be based on $100,000 minus $25,000, equaling a taxable value of $75,000. An alternative is to make the exemption equal to a percentage of the average home value in the county (i.e., 20 percent). If homes averaged $100,000 in a county, the exemption would be equal to $20,000. In a county where homes averaged $80,000. The exemption would equal $16,000. This means the tax savings to the homeowner would vary by county in proportion to the average value of homes within the county.

- **Residential Tax Credits** – A residential tax credit simply subtracts an amount from the homeowner's bill. The amount can be a fixed amount (i.e., $100) or based on a level of assessed value (i.e., $25,000 of assessed value).

4. Tax Relief Targeted By Income

These alternatives provide relief to homeowners based on their income or ability to pay and are often called "circuit-breakers". They typically provide the most relief to those with the lowest income or those whose property taxes consume a lager proportion of their income. They generally respond to concerns that property taxes have increased excessively in relationship to an individual's income. Circuit-breakers tend to shift taxes to homeowners with higher incomes and to businesses (depending on how they are designed). Or, they may entitle the taxpayer to a refund or tax credit. In some states, a credit is taken in connection with a state income tax. These alternatives tend to result in less revenue for affected taxing districts or require an appropriation. Most alternatives would probably require a constitutional amendment, other than those directed towards senior citizens (an existing constitutional amendment already provides greater flexibility in providing property tax relief to seniors). Circuit-breakers tend to be fairly expensive to administer. Thirty-three states have some type of circuit-breaker program. Twenty of these states provide benefits to elderly homeowners or renters only.

- **Residential Circuit-breaker –** This option would eliminate the tax liability for any amount that exceeded a percent of the homeowner's income. For example, a homeowner earning $30,000 would not pay any tax exceeding 6 percent of his or her income (or $1,800). The tax savings could be realized through a tax credit or a refund.

- **Remove Age Restriction on Current Senior Exemption** – Currently, senior citizens with incomes under $28,000 are entitled to property tax relief. They are exempt from special levies, and if their income is less than $18,000, they also receive a partial exemption from regular levies. Property valuations are frozen when they enter the program. Under this option, the age restriction (age 61) could be eliminated so that all homeowners meeting the income requirements could qualify.

- **Deferral Options** – Senior citizens with incomes under $34,000 currently have the option to defer their property taxes until the sale, transfer, or inheritance of the property. This program could be expanded to allow all ages and, perhaps higher income individuals to participate. This program requires a state appropriation since the state pays the property taxes on behalf of the taxpayer until the taxpayer no longer owns the property. In the longer-term, the deferred taxes are repaid.