Center on Budget and Policy Priorities

POLICY BASICS

PROPERTY TAX CAPS

Caps can affect all services financed by property taxes, from salaries for local government employees (such as teachers, police officers, and firefighters) to road and school construction, park maintenance, and human services."

Policy Basics is a series of brief background reports on issues related to budgets, taxes, and government assistance programs.

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The property tax is a major source of funding for public safety, schools, roads, libraries, and other services in most American communities. In recent decades, concern over rising property tax bills has led a number of states to impose some form of limit on the amount of property tax revenue that counties, municipalities, or school districts can collect. Several other states are considering property tax caps, even though average property taxes are low by historical standards when measured as a share of the economy (see graph).

Several Types of Caps

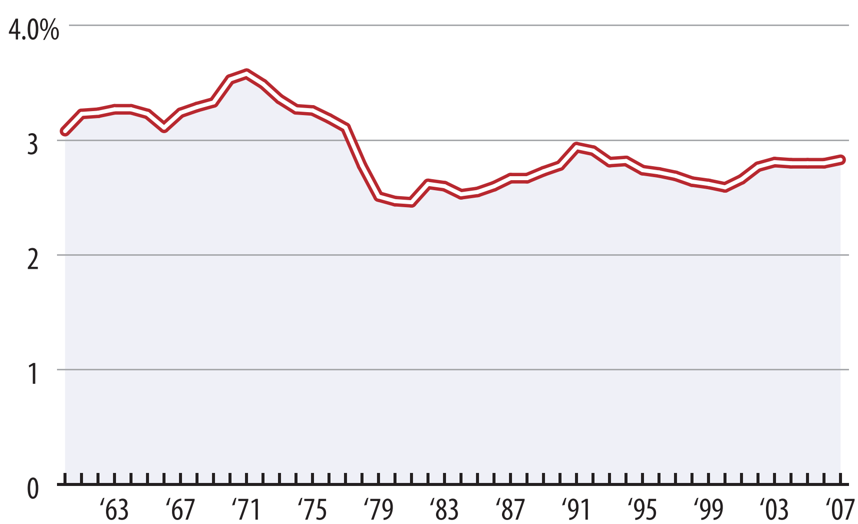
Generally speaking, an individual's property tax bill is calculated by multiplying the local property tax rate by the assessed value of his or her property. Different kinds of property tax caps focus on different elements of this equation. "Rate caps," for example, place a ceiling on the property tax rate. "Assessment caps" limit the annual increase in the assessed value of any individual's property. "Total levy caps," the most restrictive type of cap, limit the annual increase in a locality's total property tax revenue.

How Caps Affect Public Services

Caps can affect all services financed by property taxes. Property tax revenues mostly pay the salaries of local government employees such as teachers, police officers, and firefighters. In many communities, they also pay for road and school construction, park maintenance, human services, and other items. The costs of all these items rise from year to

Average Property Taxes Low by Historical Standards

Property taxes as a share of GDP



Source: Calculated from Bureau of Economic Analysis, National Income and Product Accounts.

year due to inflation, population growth, and sometimes other factors, such as changes in state law, or changes in the mix or quality of services needed to remain competitive with other jurisdictions. Localities must offer salaries that are competitive with the private sector in order to attract qualified workers.

Arguments for and Against Caps

Proponents argue that tight property tax caps will force localities to provide services more cost-effectively, or to eliminate services that are not needed. Opponents content that caps are more likely to force localities to cut necessary services. As an example they point to California, where education, health care, transportation, and other public services all have declined dramatically since the state adopted a tight property tax cap (Proposition 13) in 1978. California's school system, formerly one of the best in the country, became one of the worst.

Similarly, some Massachusetts towns have had to lay off school and municipal employees (including fire and police), freeze wages, and close town libraries and senior centers in order to comply with Proposition 2 ½, that state's severe property tax cap.

Mitigating the Impact

Some states that have adopted property tax caps have increased their local aid at the same time in order to help localities offset the loss of revenue. (This may require tax increases at the state level.) But there's no way to guarantee a state will sustain this increase over time — particularly during economic downturns, when state aid to localities often declines.

Localities can also mitigate the impact of a tax cap by voting to override it. (Most existing caps allow temporary or even permanent overrides.) Override campaigns are costly, however, and may become highly politicized.

Moreover, override systems have proven to be inequitable. More affluent communities pass overrides much more often than lower-income communities. This can exacerbate disparities across a state in education and other important services, leaving poorer communities even worse off relative to their wealthier counterparts.

A "Circuit Breaker" Alternative

In lieu of caps, states can provide targeted tax relief to property owners facing unaffordably high tax bills in ways that do not undermine public services.

One option is a "circuit breaker." Just as the circuit breaker in a home cuts off the electricity if the circuit becomes overloaded, circuit breaker programs cap a family's property tax liability if it represents too high a share of the family's income; households whose property tax payments exceed the limit receive a rebate from the state. This allows the property tax to continue to fund essential services like education at the local level, while targeting state-financed refunds to those who are in greatest need of assistance. Some 18 states have circuit breakers.

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