Setting the Context for Commission Deliberations

Prepared by Frank Mauro for the February 12, 2008, meeting of the NYS Commission on Property Tax Relief

Expanded Version

Setting the Context for Commission Delierations – Setting an Agenda

- Thank you very much for inviting me to participate in today's session and to share my thoughts on the key issues that need to be addressed in answering the questions that Governor Spitzer has posed for you.
- I will not be sharing my opinions with you today on policy issues but will do so as you begin digging into the details and the pros and cons surrounding these issues.
- The purpose of today's briefing is to contribute whatever I can to your agenda setting efforts without putting the cart before the horse.

1. The Root Causes of New York's High Property Tax Burden

- While there are many factors that might legitimately be addressed in answering this question, I think that the most significant factors are:
  - The responsibilities that New York State assigns to each of its several types of local governments.
  - The amount of aid that the state provides to those local governments to help them cover the cost of those responsibilities
  - The revenues that those local governments are authorized to collect to pay for the share of those responsibilities that the state does not cover.

2. The impact of increased state financial support and state taxpayer relief and rebate programs on school district budgets and levies

- This is a conceptual question as well as an empirical one.
- It is important to keep in mind that the STAR Exemptions do not reduce school districts' levies. Rather it provides for the state to pay part of the levy.
- The STAR Rebates are completely outside the budget and the levy.

3. The extent of voter involvement in the development and approval of school and other local government budgets

- The relationships between state aid, school budget votes and real property tax levels
- What information is available to school districts and voters at the time of budget votes? What information should be available?
- How does (how could) the new foundation formula system system relate to school budget votes?

4. The effectiveness of various state mechanisms to provide property tax relief to different classes of taxpayers

- Not sure what “classes of taxpayers” means.
- If it means owners and renters vs businesses, etc., it raises one important set of issues.
- If it means income categories, it raises a different set of issues but my contribution on this point is that the key variable is not income by itself but the level of one’s property taxes to one’s income. The crux of the equity problem is that there is no hard and fast relationship between the two.

5. The effectiveness and impact of property tax caps.

- School budgets in New York, as in most states, are composed primarily of local property tax revenues and state aid. The proportion of the two to each other varies tremendously from state to state.
- The impact of such property tax caps on educational attainment depends in large part on what happens to the other major component of school budgets (and also on "out of the blue" cost increases).
- Caps on growth also imply that there is some wisdom as to where different school districts are currently.

6. What is the most effective approach to imposing a limit on local school property tax growth without adversely impacting the ability of school districts to provide a quality education to all students.

- Study other Northeastern states with the kinds of economic disparities that New York has
- Study the New York experience
  - HURD Aid
  - Small Cities Aid

The Property Tax – Strengths and Weaknesses

- The property tax is the primary source of local tax revenue for local school districts in New York State and in the rest of the nation.
- While the use of the property tax for this purpose has many strengths in terms of the stability and breadth of its base, it raises two equity concerns:
  - Equity among and between school districts.
  - Equity among and between individuals.

Inequities Among and Between School Districts

- Great differences exist among school districts in terms of the size of the property tax base relative to the number of children to be educated and their educational needs.
- The result is that some districts can generate a lot of revenue per pupil with relatively low tax rates while other districts can generate very little revenue per pupil even with relatively high tax rates.
- One of the major purposes of state aid to education is to make up for the uneven distribution of needs and resources among school districts.
- While the current school aid system serves this purpose to some degree, the proposed operating aid reform plans are intended to do a much better job on this front.

Using the "Foundation" Approach to Provide Equity Among School Districts

- Begin by requiring all districts to apply a uniform basic tax rate (except for districts that can fully meet their Sound Basic Education (SBE) funding needs with a lower rate.)
- In districts with a lot of taxable full value per pupil, this will generate a lot of funding per pupil. In districts with relatively little taxable full value per pupil, this will generate much less funding per pupil. But the required tax effort will be the same regardless of where someone lives.
- Each district's basic state operating aid would then equal **the difference between** (a) its Sound Basic Education (SBE) funding needs, **<u>and</u>** (b) the amount of money that it can generate through the application of the uniform basic tax rate.

Inequities Among and Between Individuals

- Some inequities among individuals are attributable to the assessment process.
- State-calculated "Equalization Rates," if done well, can make up for differences among and between assessing units in terms of their average assessment ratios. But "Equalization Rates" can **<u>not</u>** make up for differences in intra-jurisdiction, intra-property-class variations in these ratios.
- Unless all properties in a community (particularly all properties of a particular type) are assessed at a uniform percentage of full value, taxpayers with homes of the same value can have very different tax bills.
- But even with fair and equitable assessment, the property tax still raises questions about equity among individuals since there are people who are "property-rich and income-poor."

The Property Tax is Burdensome for People Who are “Property-Rich and Income-Poor”

- The property tax is particularly burdensome for people with above average home values and below average incomes.
- In this regard, we frequently think of the elderly and farmers, but even within these categories there are some people with lots of income relative to their taxable property values and others with limited incomes and high taxable property values.
- In the current economy, there are an increasing number of displaced workers who are also in this situation – sometimes for a short period of time but sometimes for years.

NYS has Implemented Many Responses to this Property/Income Mismatch

- Since 1966, NYS has authorized school districts (and other local taxing jurisdictions) to provide a locally-financed sliding scale exemption for elderly homeowners.
- Since 1978, NYS has provided low income households with a refundable real property tax “circuit breaker” credit for the portion of their property taxes (or the portion of their rent that is attributable to property taxes) that exceeds a specified (sliding scale) portion of their income.
- Since 1980, NYS has taken the Adjusted Gross Income of each district’s full-time residents (relative to its pupil count) into consideration in allocating state aid to education.

NYS's Responses to the Property/ Income Mismatch (continued)

- Since 1981, NYS has authorized (a) school districts and other local taxing jurisdictions outside NYC and Nassau County to use a 2-rate system that applies a lower rate to homestead parcels (1, 2 and 3 family homes) than to other (non-homestead) parcels, and (b) NYC and Nassau County to use a "class shares" system for allocating property tax levies among four property classes.
- Since 1997, NYS has provided farmers with a refundable state income tax credit for all or a portion of their school property taxes paid.

NYS's Responses to the Property/ Income Mismatch (continued)

- In 1978, NYS began a program of Small Cities Aid for small city school districts that were close to their constitutional tax limits. Over time, this program was expanded to include some small city school districts that had substantial tax bases relative to their student population and which were not near their constitutional tax limits.
- In the 1980s, and again during the last two years, NYS has had a special aid program called "High Tax Aid."

NYS's Responses to the Property/ Income Mismatch (continued)

- Under the STAR program (which was phased in between 1998 and 2001), NYS now pays a portion of the school property tax bills for all owner-occupied dwellings regardless of a homeowner's income, and a higher portion of the bills of elderly homeowners with incomes below.

- In 2006 and 2007, NYS sent rebate checks to STAR beneficiaries. The 2007 checks varied in size for based on income. There were also other significant differences between the two years' programs.

The Local-Option Exemption for Elderly Homeowners with Limited Incomes

- Originally enacted in 1966, RPTL §467 authorizes local taxing jurisdictions including school districts to provide a 50% exemption to homeowners aged 65 and over with incomes up to a maximum level established by state law. That maximum income level has been increased 15 times from its original $3,000 to its current $24,000.
- Since 1983, local taxing jurisdictions have also been authorized to provide, on a sliding scale, exemptions of 45% and less for homeowners with incomes above the maximum level for the full 50% exemption. Under the currently authorized schedule, localities can adopt a reduction schedule with up 9 steps, with homeowners with incomes of between $31,500 and $32,400 being eligible for the lowest possible exemption of 5%.
- Several years ago, the NYS Office of Real Property Services reported that 142 school districts had opted to provide this exemption without an additional sliding scale, 528 had opted in with a sliding scale and 18 were not participating.

Real Property Tax “Circuit Breaker” Credit

- Since 1978, NYS has allowed low income homeowners and renters with the opportunity to receive a refundable credit of 50% of the amount by which their real property taxes paid (or 25% of their rent exclusive of utilities and board) exceeds a sliding scale portion (from 3½ % to 6½ %) of their total household income.
- This credit is administered through the income tax system. Eligible households that are not otherwise required to file income tax returns can still qualify for this credit by filing the necessary form with the NYS Tax Department.
- The income ($18,000), home value ($85,000) and average monthly rent ($450) limits for this credit, and the maximum credit amounts ($375 for taxpayers aged 65 and over and $75 for younger taxpayers), have not been increased since 1986.
- As a result of the state’s failure to update the program’s parameters (and the implementation of the STAR program), the number and amount of the Circuit Breaker credits claimed has declined from approximately $50 million per year in the early 1990s to approximately $32 million per year during the first several years of the current decade.

Use of Income Per Pupil in Calculating School Districts' State Aid Apportionments

- Beginning in 1980, NYS began to use Adjusted Gross Income (of school district residents) per pupil as a measure of "ability to pay" in the apportionment of state aid to school districts.
- By the 1984-85 school year, this measure was given equal weight with the traditional "Taxable Full Value Per Pupil" measure of ability to pay through an average known as the Combined Wealth Ratio.
- The use of the Income Per Pupil measure in apportioning school aid is designed to provide property tax relief to the residents of districts with lower average incomes by providing them with relatively more state aid than districts that are otherwise the same but which have higher average incomes.

Differential Assessment Ratios and Differential Tax Rates

- In its 1975 decision in the case Hellerstein v. Assessor, Town of Islip, the New York State Court of Appeals ruled that state law required all properties to be assessed at their true market value. After a series of contentious debates, the State Legislature amended the law in 1981 to authorize assessment at a uniform percentage of full value.
- This 1981 law also authorized New York City and Nassau County to assess each of four different classes of property at different percentages of full value. As a result of this class shares system, one, two and three family homes in New York City are assessed today at a much lower percentage of full value than are industrial, commercial and utility properties.
- Other local governments are not authorized to assess various classes of property at different percentages of full value, but that same 1981 law authorized local taxing jurisdictions outside of NYC and Nassau County to adopt separate homestead and non-homestead tax rates as a way of providing a measure of tax relief to all residential properties. A small number of school districts currently avail themselves of this option.

Farmers’ School Property Tax Credit

- Since 1997, NYS has provided farmers with a refundable income tax credit for all or a portion of their school property taxes paid.
- To be eligible, two-thirds of a taxpayer’s federal income must come from farming. The credit currently equals 100% of the school property taxes paid on up to 250 acres of qualified agricultural property in the State and 50% of the school property taxes paid on acres in excess of 250.
- The full credit is available to taxpayers with incomes of $100,000 or less. A partial credit, calculated on a sliding scale basis, is available for taxpayers with adjusted gross income between $100,000 and $150,000. For example, a taxpayer with AGI of $125,000 would be entitled to 50% of the credit available to a similarly situated farmer with income of $100,000 or less.
- In each of the three years following the initial enactment of this credit in 1996, amendments were adopted expanding it, accelerating its phase-in or liberalizing its rules. The annual cost of this credit has grown steadily from $12.4 million in 1997 to an estimated $23 million in 2003.

STAR: The School Tax Relief Program

- Enacted in 1997 and phased in over a four year period, beginning with the 1998-99 school year, STAR is now, by far, the state’s most widely used and largest tax exemption program.
- Under STAR, all owner-occupied residential dwellings in the state are eligible for a state-funded homestead exemption of at least $30,000. In counties in which the median home value is greater than the statewide median home value, the value of this exemption is prorated upward by the ratio of the county median to the statewide median. In Westchester, the county with the highest median home value, this exemption is prorated up to $82,550.
- Homeowners aged 65 and over, with incomes below $60,00 (adjusted upward for inflation beginning in 2003) are eligible for an “enhanced” STAR exemption of $50,000. This exemption is also prorated up in counties with median home values above the statewide median. In Westchester, for example, this exemption is currently $137,590. (Note: All of these values are adjusted up or down based on local equalization rates.)

STAR: The School Tax Relief Program

- In the 2001-2002 school year, the first year in which STAR was fully phased-in, the NYS Office of Real Property Services reported that there were nearly 640,000 “enhanced” STAR exemptions and more than 2.2 million “basic” STAR exemptions representing $118.9 billion in exempt value.
- According to the State Comptroller’s analysis of the annual financial reports submitted by the state’s school districts for the 2001-2002 school year, STAR exemptions accounted for $1.875 billion in revenues for school districts outside New York City – slightly more than 15% of the $12.394 billion in property tax revenues collected by those districts. New York City received $112 million in STAR reimbursements – 2.1% of the city property tax revenues allocated to the NYC school system.
- In recognition of the limited benefits that would accrue to New York City under the STAR property tax exemption, the initial STAR legislation established a special New York City STAR Supplement which provides for a state-funded reduction in the NYC resident income tax. This element of the program provided NYC residents with $520 million in income tax relief in 2001-2002.

How Effective and How Cost-Effective are New York’s Property Tax Relief Mechanisms?

- How effective and how cost-effective are New York’s various property tax relief mechanisms?
- How well do New York’s various property tax relief mechanisms fit together?
- What other aspects of the tax system work at cross purposes with these property tax relief mechanisms?

Impact of Internally Financed Property Tax Relief Mechanisms

- Both the Local-Option Senior Citizen Exemption and the application of differential rates to homestead and non-homestead properties reduce the tax on some local property owners by increasing the tax for others.
- The Local-Option Senior Citizen Exemption decreases the property tax burden for elderly homeowners with limited incomes but it increases the tax burden for all other property owners including non-elderly homeowners with lower incomes relative to their property tax bills.
- The application of differential rates for homestead and non-homestead parcels shifts some of the tax burden from all one, two and three family homes (regardless of the income of the owners) to all other property owners.

Means-Tested vs. Non-Means-Tested Property Tax Relief Mechanisms

- The Local-Option Senior Citizen Exemption, the Circuit Breaker Credit, the Framers School Property Tax Credit and the Enhanced STAR Exemption all have means tests.
- The first three of these programs have sliding scales of one sort or another.
- The Enhanced STAR Exemption, on the other hand, has a single threshold-type income test, thus creating an irrational notch effect. Elderly taxpayers with incomes of slightly less than $60,000 get benefits that are 2/3rds more than taxpayers with only slightly higher incomes. There are no other income tests so that two elderly homeowners with equal property tax bills get the same relief even if one has income of $20,000 and the other has income of $50,000.

Means-Tested vs. Non-Means-Tested Property Tax Relief Mechanisms

- The $18,000 income limit in the Real Property Tax Circuit Breaker is completely outdated, not having been raised since 1986 while the $150,000 limit for the Farmers' School Property Tax Credit is quite generous.
- While the Farmers' School Property Tax Credit has a sliding scale in the $100,000 to $150,000 phase-out range, it treats all eligible taxpayers with incomes below $100,000 the same- whether their income is $40,000 or $90,000.
- The Real Property Tax Circuit Breaker is the only one of the means-tested programs that looks not just at income but at the relationship between a household's income and its property tax bill.

Current Property Tax Relief Mechanisms Have Various Pros and Cons

- The Basic STAR Exemption, the use of the Income Per Pupil measure in the apportionment of school aid, and the application of differential rates for homestead and non-homestead parcels all provide the same relief to homeowners within a given district whether their incomes are high or low relative to their property tax bills.
- In the case of a state-financed exemption such as the Basic STAR Exemption, the result is a program that is not cost-effective, i.e., it is very expensive relative to the amount of relief that is delivered to households that are truly overburdened by their property tax bills.
- The use of the Income Per Pupil measure, by delivering property tax relief on the basis of the average income of district residents actually has the effect of further increasing the burden of taxpayers whose incomes ith incomes that are low relative to their property values who happen to live in districts with high average incomes.

A Greatly Enhanced Circuit Breaker

- A greatly enhanced circuit breaker could provide significant relief to overburdened taxpayers in a much more effective and cost-effective manner than the current hodgepodge of property tax relief mechanisms.

Increasing the Credit's Parameters

- The maximum home value should be increased from the current $85,000 to something in the range of $300,000 to $450,000. The maximum monthly rent should be increased from $450 to something in the range of $1,600 to $2,400.
- The maximum income level should be set at relatively high level particularly if an enhanced circuit breaker replaces STAR completely or at the high end of the income scale. One possibility is to set the limit at the level at which the top bracket of the federal income tax kicks in – currently $311,950 of taxable income.

Giving Taxpayers the Choice of a Rebate or a "Prebate"

- One of the attractive features of the current STAR program is that taxpayers' property tax bills are reduced up front.
- Vermont's Circuit Breaker gives taxpayers the choice of **either** paying their property taxes and then claiming a rebate **or** applying for an education property tax payment (a prebate) based on their previous year's property tax bill and their previous year's income.