TTARA
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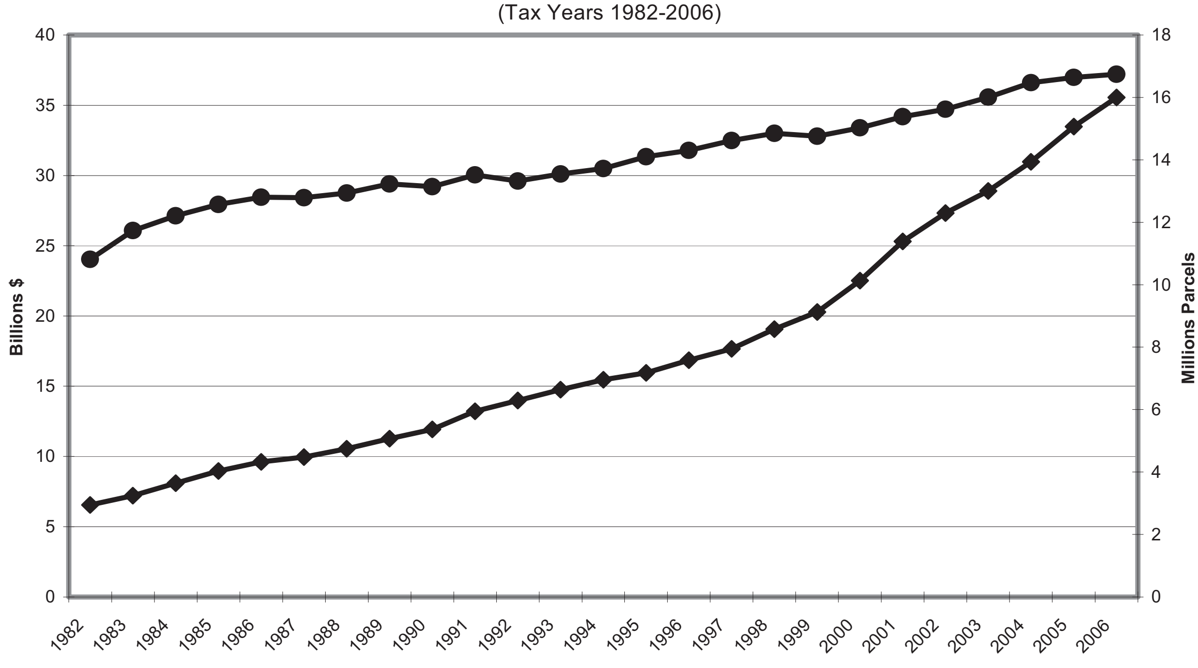
Texas Property Taxes: Past & Present

Texans pay more in property taxes than in any other tax. Levies totaled $35.6 billion on 16.7 million taxable parcels of property in the 2006 tax year, the most recent year for which the Comptroller has reported levies for all taxing jurisdictions (Figure 1). The 2007 data will reflect the final round of mandated school tax rate reductions and is expected to show a drop in the total to $34.6 billion, with school districts at $18.9 billion or 55% of the total. The 2006 total shown is 442% larger than the $6.6 billion levied in 1982, the first year in which the current property tax system was fully implemented.

Figure 1
Total Property Tax Levies & Taxable Parcels
(Tax Years 1982-2006)

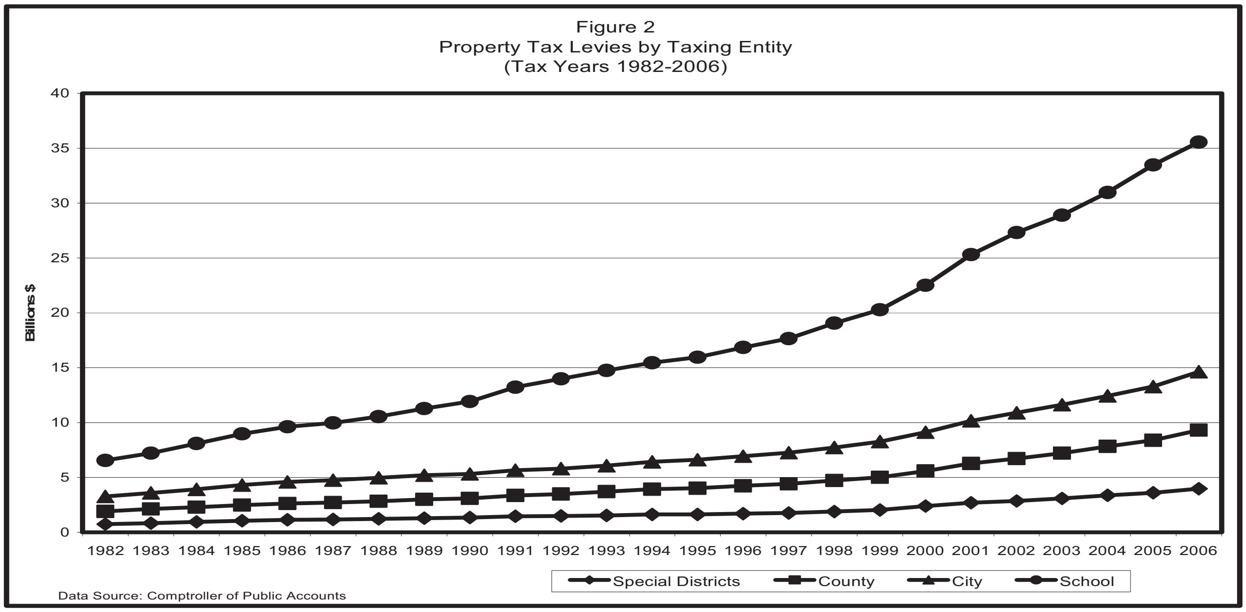


Data Source: Comptroller of Public Accounts

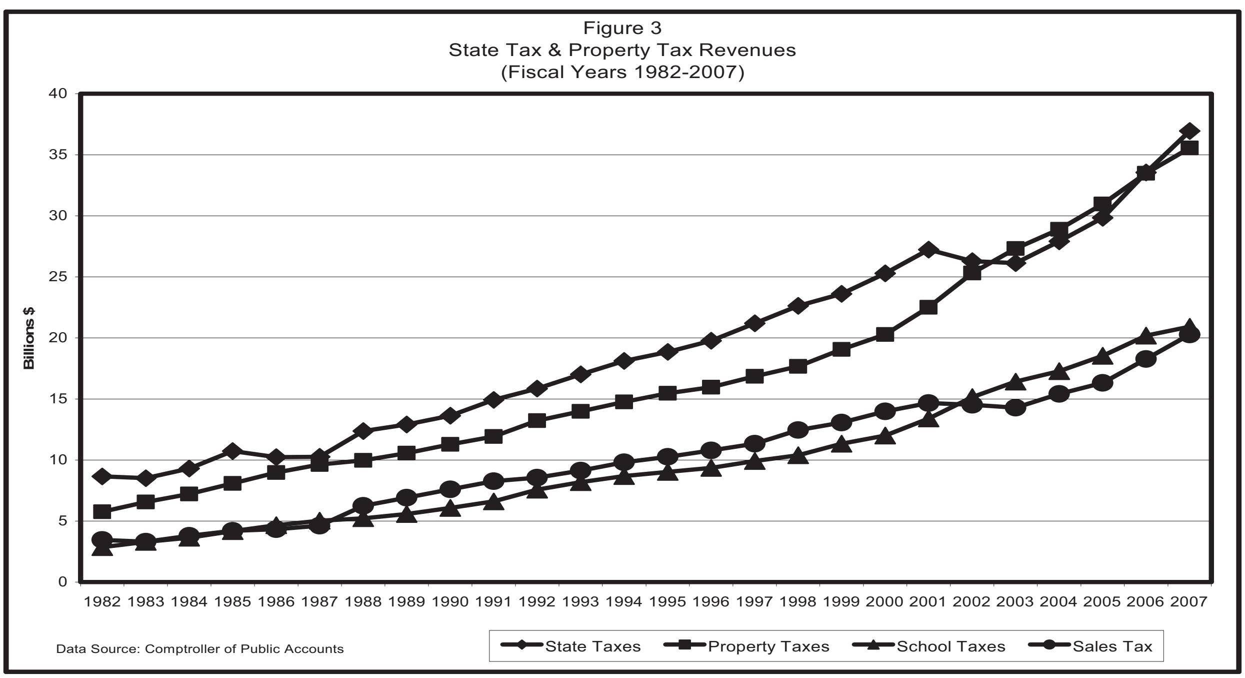
As reported by the Comptroller, school property taxes at $20.9 billion accounted for about 59% of the $35.6 billion total (Figure 2). City and county taxes each amounted to about $5.3 billion, or 15% each of the total, and special district levies of $4 billion comprised the remaining 11%. Although the 536% increase ($3.3 to $20.9 billion) in

400 West 15th Street, Suite 400, Austin, TX 78701 * Phone 512-472-8838 * Fax 512-472-2636

school taxes from 1982 to 2006 was the largest, property taxes of all taxing entities grew in tandem (special districts-436%, counties-358%, and cities-292%).



Of every dollar in state and local taxes collected in Texas in the 2007 state fiscal year, 49 cents came from the property tax and it accounted for about three-fourths more revenue than the next highest tax, the $20.3 billion state sales and use tax (Figure 3). Property tax revenues are reported on a tax year basis, which relates to the taxes levied on property values as of January 1 and collected from the following October (after the September 1 state fiscal year start) through January of the next year. Thus, each property tax year's revenues correspond with state tax revenues in the following state fiscal year – e.g. 2006 property taxes relate to 2007 state taxes.



It is something of a misnomer to refer to the property tax since it is separately levied by more than 3,800 taxing jurisdictions at different rates on different tax bases. Property taxes in Texas are imposed only by local governments. They are the only source of tax revenue for school districts, provide most of the tax resources for counties and special districts and generate about one-fourth of cities' revenues.

Since its addition in 1968, Article VIII, Sec. 1-e, Texas Constitution, has prohibited a state property tax levy. That has not always been true. Until its abandonment in 1951 as a source of general revenue, a state property had been levied, but its importance as a state revenue source had declined significantly during the preceding decade. After the 1968 change, the Constitution continued to authorize state property taxes for limited purposes until the last of such taxes, a ten-cent per $100 tax to support college construction, was terminated by statute in 1979 and by constitutional amendment in 1982.

Financing Government with Property Taxes

The property tax nationwide is the mainstay of local taxation and is used very sparingly as a state revenue source. The characteristics of the property tax make it particularly well suited to financing local governments. It is the only tax for which a rate must be adopted each year. Consequently, it acts much like a government finance "shock absorber" since the approved rate can be adjusted up or down within authorized levels to account for changes in property valuations from year to year.

The U.S Census Bureau is the only source of nationwide data on government finances and the most recent numbers are for the 2004-05 fiscal year (Figure 4).

Figure 4
Property Taxes as a % of State & Local Taxes
2004-05

	State & Local Taxes	Texas Rank	State Taxes	Texas Rank	Local Taxes	Texas Rank
Texas	43.8%	3	0.0%	38T	83.3%	17
US Average	30.6%		1.8%		72.4%	

Data Source: U.S. Census Bureau, Governments Division

The data reported shows that Texas is among thirteen states with no state property tax receipts and that property taxes exceed 1% of state revenues in only seventeen states. In just five states does it amount to as much as one-tenth of state taxes – Vermont-33%, New Hampshire-19%, Washington-11%, Wyoming-10%, and Montana-10%. In states with significant state property taxes, they are either directly administered by the state or levied with strict state oversight to ensure uniformity. Figure 4 also shows that Texas relies more heavily than most states on the property tax to fund local government services and that Texas is third highest in the nation in using the property tax to fund all state and local government services.

How High Are Property Taxes?

By any measure, the property tax burden in Texas is high compared to those in other states. The most common methods of comparing property tax burdens across the country are either on a per capita basis or as a percentage of personal income. Texas ranked fourteenth and eleventh highest respectively on those two measures in 2005 but the Texas burden, although notably higher, was not shown to be dramatically above the national average (Figure 5). However, these two aggregate measures are very crude approximations and at best provide only a general idea of how property tax burdens actually compare.

Figure 5
Property Taxes Per Capita & Percent Personal Income
2004-05

Property Taxes	US	Texas	Texas Rank	Texas as % of US
Per Capita	$1,134	$1,325	14	116.8%
% of Per Capita Personal Income	3.3%	4.0%	11	122.1%

Source: U.S. Census Bureau, Governments Division

Depending on location and type of property, tax burdens will vary significantly both between and within states. Depending on its location, property can be subject to taxes levied by multiple overlapping taxing jurisdictions with different tax rates and exemptions. By policy or by valuation practices, either official or unofficial, tax burdens also can be much different depending on the type of property being taxed.

The most meaningful comparisons require measuring relative tax burdens at specific locations for like properties. The only study that provides such information is a report produced cooperatively by the member states of the National Taxpayers Conference, an organization of statewide associations, like and including TTARA, that are devoted to the pursuit of objective and unbiased analysis of public finance issues. The data is compiled by the Minnesota Taxpayers Association which in April 2007 released the sixth and most recent edition entitled *50-State Property Tax Comparison Study, Payable Year 2006*.

The study calculates and compares effective tax rates for four types of property at different levels of market value in the largest city and a typical rural city in each state. Effective tax rates take into account the effects of statutory tax provisions (e.g. exemptions and credits) and local valuation practices. These rates express the relationship between net property taxes and true market values and, consequently, provide a more meaningful comparison across states and property types.

Figure 6 shows how effective tax rates in Texas for homesteads, apartments, commercial and industrial properties at designated market values in both urban and rural locations compare to the national average and where Texas ranks among the states. Texas rankings are consistently high and tax burdens frequently exceed the national average by more than fifty percent, led by the nearly double burden on rural industrial property

Figure 6

Property Tax Burden Comparisons

2006

Type of Property	Texas Rank Among the States	Texas Effective Tax Rate	US Average Effective Tax Rate	% of US Average	Texas Rate with $1.04 School M&O Tax Rate	Texas Rank with $1.04 School M&O Tax Rate	% of US Average
HOMESTEAD ($150,000)							
Urban	6	2.086%	1.301%	160.5%	1.626%	13	125.0%
Rural	9	1.867%	1.275%	146.4%	1.407%	17	110.4%
APARTMENTS ($630,000)*							
Urban	6	2.742%	1.707%	160.6%	2.282%	12	133.7%
Rural	5	2.506%	1.532%	163.6%	2.046%	12	133.6%
COMMERCIAL ($30M)*							
Urban	17	2.395%	1.979%	121.0%	1.935%	24	97.8%
Rural	6	2.506%	1.649%	152.0%	2.046%	14	80.6%
INDUSTRIAL ($50M)*							
Urban	3	2.862%	1.724%	166.0%	2.402%	6	139.3%
Rural	4	2.506%	1.269%	197.5%	2.046%	5	161.2%

Note: Urban location is largest city (Houston) and rural location is typical rural city (Fort Stockton).
Effective tax rate of 2.086% equivalent to $2.086 per $100 valuation.

* APARTMENTS -- $600,000 real property & $30,000 fixtures.
COMMERCIAL -- $25M real property & $5M fixtures.
INDUSTRIAL -- $25M real property, $12.5M machinery/equipment, $10M inventories & $2.5M fixtures.

Source: *50-State Property Tax Comparison Study, Payable Year 2006*, National Taxpayers Conference

The study data does not reflect the recent reductions in Texas' school tax rates; that comparison must await the next edition of the study. For illustrative purposes, however, Figure 6 shows how Texas would have compared if school taxes were 46-cents per $100 lower across the board. This rate reduction is used rather than fifty cents since most school districts have opted to levy the additional four cents allowed without voter approval. Except for commercial property, Texas taxes still would have exceeded the national average and would have remained especially high on industrial property.

Where We Were, Where We Are & How We Got Here

Many now consider Texas to have one of the best, if not the best, property tax administration systems in the nation. That has not always been the case. It is said that major public policy reform is not for the short-winded and that those who take on the task should have a geologist's sense of time. The path to property tax reform in Texas evidences the truth of both those observations.

Prior to adoption of the Property Tax Code in 1979, property taxes in Texas, as in most other states, were poorly and unfairly administered by too many badly equipped and under staffed tax offices operating in a manner that was neither equitable nor legal.

The essential elements of a quality property tax system can be summarized as follows:

- A tax base that can be equitably and efficiently administered
- One taxable value for each property
- A professionalized valuation function
- A state agency responsible for monitoring and upgrading tax administration
- Full disclosure to taxpayers
- A workable and meaningful appeals process

It is fair to say that the Texas system prior to 1979 had none of these qualities; in fact quite the opposite was true. In most respects, the Texas system was a model of how best <u>not</u> to administer the tax. It is no exaggeration to say that: there was not a single constitutional tax roll in the state; administration was neither legal nor equitable; and taxpayers had little chance of securing redress of inequities.

There were as many as 2,000 or more tax offices with overlapping jurisdictions that were independently valuing property so that taxpayers received duplicate valuations. Despite legal requirements for uniform valuations, property commonly was taxed at different levels of market value both between and within districts by type of property. The actual condition of valuation equalization bore no relationship to legal requirements. Taxpayers were routinely given little information and even the most sophisticated had difficulty in ascertaining actual valuation levels. The appeal process was burdensome and provided little real chance for relief, even in the courts. Property taxes were viewed as a local government function and the state never concerned itself directly with property tax administration, even when it was levying a state property tax.

The deficiencies in property tax administration were not unknown and, in fact, were chronicled in a number of studies that all called for reforms. Among the most prominent of these are listed on page 8.

Despite widespread criticisms, public concerns and calls for reform, both the Legislature and the courts were for the most part unresponsive. Major reasons for inaction included: dislike of the property tax in general; the built-in inertia of a long-standing system; fear of resulting tax increases on currently favored taxpayers, especially homeowners and agricultural producers; and loss of control by local taxing authorities.

The necessity for school finance reform ultimately proved to be the key to accomplishing fundamental and dramatic changes in property tax administration. The road to the reforms enacted in 1979 really began with a federal lawsuit challenging the school finance system's constitutionality that was filed by Demetrio Rodriguez and a group of other parents of students in Edgewood ISD. On December 23, 1971, a three-judge panel of the U.S. District Court in San Antonio ruled in *Rodriguez v. San Antonio ISD* that the system violated the equal protection clause of the federal constitution due in large measure to inequities in the property tax system. The decision was appealed to the U.S. Supreme Court which overturned the lower court ruling on March 21, 1973. In essence the Court said that the Texas system was unfair, but that education was not a fundamental right guaranteed by the U.S. Constitution. The Court noted the need for reform but stated that job was the responsibility of state lawmakers.

At the time of the Rodriguez decision, state school aid was distributed through a "county economic index" system established in 1949 in the landmark Gilmer-Aiken school bill. The index was comprised of a number of factors, including: scholastic population; value added by manufacturing; cash value of farm products; wholesale, retail and service industry payrolls; and county assessed valuations. The index was recognized almost from the beginning as a poor basis for measuring local taxing capacity. There was a multi-year time lag in getting the necessary economic data and there was no uniformity between counties in the valuation of property. It became apparent to state officials that a better basis for distributing state aid was essential and that equalized property valuations was the best basis on which to provide state funds to local school districts.

The school finance bill, HB 1126, adopted in 1975 distributed state aid based on the value of property in each school district in 1974 as reported by the market value study of the Governor's Office of Education Resources (GOER) which had been created by Governor Dolph Briscoe after the close of the 1973 legislative session. GOER was charged with determining the ability of each school district to provide support for public school education as determined by the market vale approach to taxation.

Basing state aid on equalized market values could best be accomplished when built upon a fair, professional and more uniform system of school property taxation. Representative Wayne Peveto in 1973 introduced the first comprehensive property tax reform bill which envisioned a county unit system for property tax administration wherein county assessors would assess all property at market value and levy and collect the taxes on those values for all taxing jurisdictions in the county. Setting tax rates was to be the only job of local taxing authorities. The bill failed to pass.

In 1975, Representative Peveto with 84 co-sponsors introduced a new reform bill, HB 1463, which basically proposed the central appraisal district system that is in place today. In the Senate, Senator Grant Jones introduced two companion reform bills, Prominent Property Tax Reform Studies

The following list summarizes the most prominent studies that criticized and recommended significant reforms in the Texas property tax system, leading up to passage of the Property Tax Code.

<u>Commission on State and Local Tax Policy</u> (1959)

- Created by the Legislature to operate for four years and report needed changes in tax policy, including in property taxes.
- December 1962 report identified deficiencies and recommended sixteen property tax reform measures.
- Entire package was defeated in the Legislature.

<u>Legislative Committee on State and Local Tax Policy</u> (1966)

- Studied operations of 71 urban tax offices that administered 80% of the taxes collected in the 24 counties in which they were located.
- Findings detailed a long list of objectionable practices.
- Virtually no legislative response to the study.

<u>Governor's Committee on Public School Education</u> (1967)

- Statutorily created at the behest of Governor John Connally to undertake a comprehensive study of public schools, including their financing.
- Proposed a school funding equalization system in response to a finding of widespread inequitable property valuations.
- Property tax system remained unchanged.

<u>Texas Urban Development Commission</u> (1969)

- Appointed by Governor Preston Smith.
- Report in 1971 recommended dramatic changes in property tax administration.
- Property tax system remained unchanged.

<u>Texas Constitutional Revision Commission</u> (1973)
<u>Texas Constitutional Convention</u> (1974)

- Commission created by legislative resolution to recommend needed changes to the state constitution in advance of the Legislature convening as a constitutional convention in 1974.
- Work of the Commission prompted the Convention's Finance Committee to recommend property valuation and appeal reforms.
- Convention was unable to agree on a new constitution to submit to voters.
- The following 64th Legislature in 1975 adopted a proposed new constitution in eight separate amendments that could be individually adopted by voters in November.
- All propositions were rejected by about a three-to-one margin, including the proposed Finance Article that contained the property tax reform recommendations of the Convention Finance Committee.

SB 887 and SB 888. HB 1463 passed the House with 106 votes, but died in Senate committee. That same session, a bill to professionalize the assessing function by the licensing and registration of property assessors passed the Senate but died in the House.

Based on the complete restructuring of the system recommended by a Property Tax Study Committee formed in 1976 as part of the Legislative Council's Recodification Project, Representative Peveto and Senator Jones, who were respectively appointed chair and vice chair of the Committee, introduced similar property tax reform bills in 1977. Once again, the reform bill passed the House but failed in the Senate.

When the Legislature was unable to agree on a public school finance bill during the 1977 regular session, Governor Dolph Briscoe called a special session in July to do so. As part of the adopted school finance bill, SB 1, a School Tax Assessment Practices Board (STAPB) was created and charged with establishing minimum standards for the administration and operation of offices that established property values for school taxation. STAPB also was to biennially determine the total value of property in each school district for purposes of state aid distribution.

In 1978 by Representative Wayne Peveto and two other citizens of Orange County filed a lawsuit in district court asserting that the tax violated the state constitutional requirement that taxes must be "equal and uniform." The crux of the argument was that, since the tax was levied on county property valuations, the state tax burden varied from county to county due to the vagaries of county valuation practices that existed at the time. In response, the tax was eliminated by the Legislature.

In July 1978, a second special session of the 65th Legislature was called to consider, among other items: a school tax homestead exemption, use valuation of agricultural lands, and a limitation on tax increases by local taxing jurisdictions. The end result was the adoption of the "Tax Relief Amendment" by voters that November which in part added Sections 21 and 23 to Article VIII of the Texas Constitution. The proposition also added Section 22 which established the limitation on the rate of growth of appropriations of non-constitutionally dedicated state tax revenues.

Article VIII, Section 23 authorized the establishment by general law of uniform standards and procedures for valuing property, provided that their administrative and judicial enforcement "shall originate in the county where the tax is imposed," and barred the statewide valuation of real property. Section 21 established the "truth-in-taxation" process to limit property tax growth and notify taxpayers of a revaluation of their property, as well as its potential effect on taxes owed. These two new sections provided the constitutional foundation for the adoption of legislation creating the current property tax administration system.

During the 66th Regular Session in 1979, the current Property Tax Code was adopted with the passage of SB 621 by Senator Grant Jones. The Code was drafted to put in place all the essential elements of a quality property tax system listed on page 6. Despite being a Senate bill, the bill has always been commonly referred to as the "Peveto Bill" in recognition of Representative Wayne Peveto's long-running reform efforts. Since its enactment, the Code has been amended numerous times but the fundamental provisions that make the Texas property tax system perhaps the very best among those of all the states have remained remarkably intact.

Where Do We Go From Here?

Property tax administration now doesn't remotely resemble what it was pre-Peveto. However, it has now been in service for more than a quarter century and a comprehensive performance review of the entire system, which has never been done, could be useful. Such a review effort might identify potential policy changes that could foster the system wide installation of "best practices" revealed over many years of experience and, by doing so, perhaps lay the foundation for further reforms in all aspects of the system – valuing property, resolving disputes, setting tax rates and collecting levies.

Prepared by John Kennedy
jkennedy@ttara.org

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