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Who Pays for Property Tax Limitation, and Who Benefits?

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Introduction

Since California's Proposition 13 became law in 1978, the majority of other states have enacted similar legislation to limit the annual increase of local property tax revenues. These property tax limitations are popular, but their costs are poorly understood.

The purpose of this brief is to review what is known about the effects of property tax limitation on how we pay for local government. Many of the most vigorous debates about property tax limitation concern its impact on other aspects of social life—critics have charged Proposition 13, for example, with distorting land-use decisions and reducing the quality of public services ranging from policing to public schools—but whatever the indirect effects of property tax limitations on such outcomes, they are generally assumed to exert those effects by changing how governments tax and spend. The focus of this brief is on the first link in the chain.

The scholarship reviewed in this brief supports a few key conclusions:

- Property tax limitations generally have the intended effect of reducing property taxes.
- The greatest property tax savings accrue to long-term property owners, potentially including many low-income and elderly homeowners.
- Local governments may increase other taxes to make up the lost property tax revenue, but the tax increases are usually small.
- Local governments subject to property tax limitation adjust to the foregone property taxes by reducing their spending more than by increasing other taxes.

Who pays the price for property tax limitation? The findings reviewed here do not include any definitive studies of this question, but they do allow us to draw some tentative conclusions. The people who face the greatest net increase in their costs as a result of a property tax limitation are people who lose access to local public services that they depend on, and who do not enjoy much property tax savings under property tax limitation because they would not otherwise pay much property tax. This description is likely to apply to many young, low-income renters whose children attend public school. But the net winners under property tax limitation also include some low-income people, especially low-income elders who own their own homes and who do not have children in public schools.

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Modern property tax limitations reduce taxes for long-term property owners

Modern property tax limitations do, in fact, cut property taxes. This might seem obvious from their name. But it cannot be taken for granted: the property tax limitations that many states adopted in the nineteenth and early twentieth centuries, for example, generally failed to slow the growth of property taxes.[1] The modern property tax levy limitations that most states have adopted since Proposition 13 are more effective at limiting the growth of property taxes. Some of their greater effectiveness may come from improvements in the consistency with which state governments enforce property tax rules. Most of their greater effectiveness, however, comes from the fact that the laws themselves are simply written to be more constraining: instead of just capping the tax rate, for example, they may also impose a numeric cap on the annual growth rate of assessed values (as Proposition 13 does in California) or a limit on the annual growth of the total property tax levy of any local government (as Proposition 2 1/2 does in Massachusetts). The impact of these property tax caps may be big or small depending on the details of the policy. Different studies come to different conclusions about just how much of a reduction in local property taxes can be expected when a state adopts a policy of property tax limitation. In states like California with particularly stringent property tax caps, the reduction is likely to be greatest.[2]

Who exactly gets the greatest tax cut under property tax limitation? In the long run, the greatest savings under an assessment limitation like Proposition 13 accrue to property owners who hold onto their property for a very long period of time while market values increase. The greatest beneficiaries may include some corporate owners of commercial property that can hold onto real estate in perpetuity. Two studies have found that commercial property owners *in general*—most of whom are not large corporations—do not benefit any more than homeowners.[3]

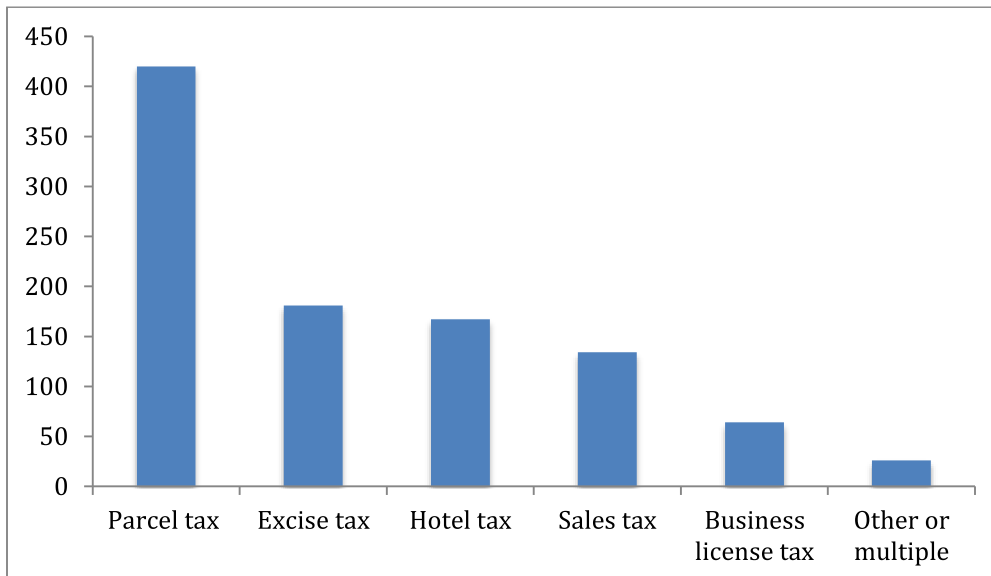
It is sometimes also assumed that Proposition 13 and other property tax limitations benefit high-income homeowners the most. This is not necessarily true. On the one hand, high-income homeowners are more likely to own expensive homes, and therefore to get a greater benefit if their homes are under-taxed relative to their market value. On the other hand, low-income homeowners may be especially likely to stay in their homes if a move would trigger a reassessment and increase their property tax bills. Many elderly homeowners in particular may have valuable homes without high incomes. Studies of different states and time periods have come to different conclusions about whether high-income or low-income homeowners benefit the most from assessment limitations, but the most thorough study of California, from the 1990s, found that low-income homeowners saw the greatest reduction in property taxes from Proposition 13.[4]

Among homeowners, the greatest tax savings accrue to the elderly, because they generally move less often than younger homeowners.[5] Tax savings may be more likely to accrue to white homeowners, at least in California, where recent home buyers are notably more racially and ethnically diverse than previous cohorts of home buyers. Young homeowners and homeowners of color may gain less tax savings from property tax limitation because they are less likely to be long-term owners of expensive real estate.

Property tax limitation can increase *certain other local taxes and fees*

Local governments subject to property tax limitation may increase other taxes to compensate for the missing revenues. Many local governments in California, for example, have adapted to property tax limitation by adopting new parcel taxes, hotel taxes, use taxes, and various other forms of taxation. Figure 1 illustrates the tax increases that local governments in California have enacted since 1995. Almost half of these increases are parcel taxes, which are effectively property taxes that apply to real estate on a per-parcel rather than an *ad valorem* or per-dollar-value basis. Excise taxes, which are sales taxes on specific goods and services, are the next most common category of tax increase; almost half of these excise tax increases are "transient occupancy taxes," commonly called hotel taxes, which are reported separately in Figure 1.

Figure 1. *Number of local tax increases approved by California voters, 1995-2010, by type of tax*



Note: N=992. Author's calculations, with coding assistance from Jane Lopez. Data from the California Elections Data Archive.

Which of these tax increases can be attributed to property tax limitation? The fact that these local tax increases happened in California *after* Proposition 13 does not mean that they all happened *because of* Proposition 13. Several studies have attempted to measure the causal impact of property tax limitation by statistical comparison of California and other states with tax limitations to states that do not have comparable property tax limitation. Table 1 summarizes the recent findings of this scholarship. There is some evidence that local governments subject to property tax limits may increase per capita revenues from sales tax or income tax.[6] The evidence about other taxes is mixed or unclear. Local governments that are subject to a property tax limitation also may increase non-tax revenue sources. Some local agencies, including public schools and fire departments, may respond by soliciting more voluntary contributions. Others may lobby for a share of state lottery proceeds. Many local governments may increase certain user fees, although it is unclear whether property tax limits cause fees to increase in general.[7]

Table 1. *The indirect effects of property tax limitation on local revenues from selected other sources*

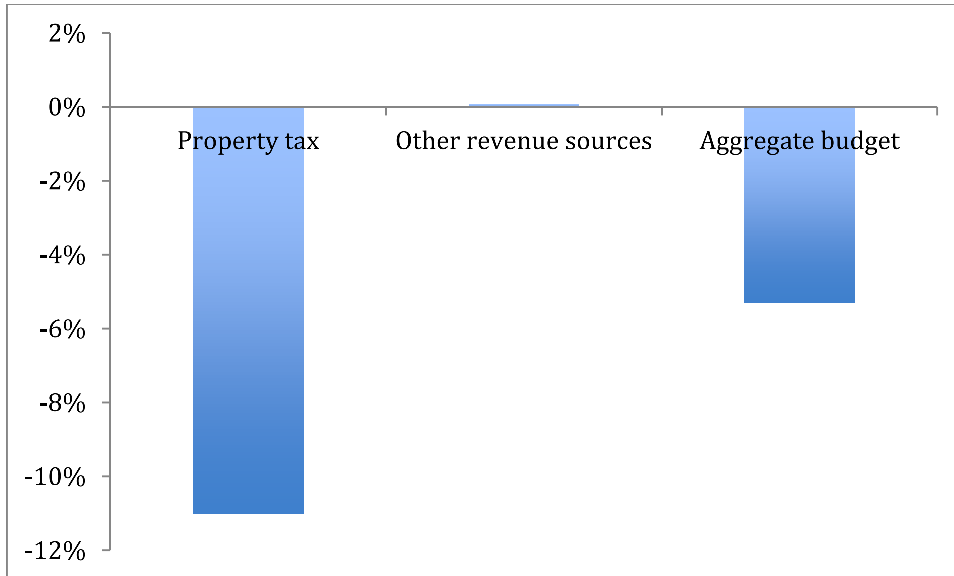
	Share of revenues	Absolute revenues per capita	References
Sales tax	…	+	McCubbins and Moule 2010, Sun 2014
Income tax	+	+	McCubbins and Moule 2010, Sun 2014
Miscellaneous other taxes	N/A	…	Skidmore 1999, Sun 2014
Charges and fees	+	+ or …	Mullins and Joyce 1996, McCubbins and Moule 2010, Jung and Bae 2014, Downes and Killeen 2014

Notes: This table summarizes estimates of the average effects of property tax limitation (or, in some cases, the average effects of all policies under the more general umbrella category of "local tax and expenditure limitations") on both the *share* of local government revenues and the *absolute per capital quantity* of local government revenues from selected non-property-tax revenue sources. The symbol + indicates a positive effect, ... indicates no statistically significant effect, and N/A indicates that no estimate is available.

Most of these tax increases are very small and on balance they do not make up for the lost property tax revenues. Figure 2 summarizes dozens of estimates of the average impact of property tax limitation on property tax revenues per capita and other revenues per capita from fourteen comparative studies. It shows that property tax limitation generally produces an 11% decrease in property tax revenues per capita. On average, the increase in local government revenues from various other sources that have been studied is less than 1%. Researchers have also found that the combined total of *all* non-property tax revenues does not increase after a property tax limitation, and may even decrease.[8] Although property tax limitations can sometimes increase some other taxes for some people, it does not do so for the average person, and there are probably relatively few people who actually pay an increased *total* tax bill as a result of property tax limitation.

Because property tax limitations reduce property taxes, and because they do not cause other taxes to increase much, they reduce the total tax revenue of local governments.[9] They also reduce local spending. In theory, a local government subjected to a new property tax limitation could continue to spend just as much as before and borrow to make up the difference. In practice, many local governments are constrained by statute or charter to balance their budgets. Even if a local government is legally permitted to operate at a deficit, doing so persistently could ruin its credit rating, eventually driving up the cost of borrowing to the point that deficit spending is no longer an option. That is why a limitation on local revenues generally also means a limitation on local expenditures.[10] The last bar on Figure 2 summarizes 59 estimates of the impact of property tax limitation on total local revenues and on various measures of local government expenditures. The net impact is negative.

Figure 2. *Estimated impact of property tax limitation on per capita property tax revenues, other local revenues, and local budgets*



Note: See Isaac William Martin, "What Property Tax Limitations Do to Local Finances: A Meta-regression Analysis," IRLE working paper.

When California voters passed Proposition 13, some optimists argued that it would actually increase public spending. Former Governor Ronald Reagan, for example, predicted that the property tax cuts would stimulate the economy of California, and economic growth would bring a "surge" of new tax revenue that would enable increased public spending.[11] Research on the impact of property tax limitation since 1978 clearly does not support this optimistic view.

Who pays the price?

Property tax limitations do indeed lower taxes for many property owners, but the increased saving for those taxpayers comes at a cost. Sometimes that cost may include increases in other taxes and fees. If local governments increase other taxes in response to a property tax limitation, then it is possible that a property tax limitation could actually cause at least some people to face an *increase* in the total taxes and fees that they pay to local government. But few, if any, are likely to be paying substantially more, simply because the offsetting tax increases are small. For the most part local governments adapt to property tax limitation by reducing public spending. This reduction can be conceptualized as a hidden tax on those who rely on public services. The consumers who depend the most on local public services—perhaps especially parents of children in public schools—are the ones who pay for property tax limitation.

This pattern of local tax increases in Figure 1 suggests that California's property tax limitation may not have changed the overall progressivity of local taxes very much. In the short term, the shift from an *ad valorem* property tax to a parcel tax will increase the taxes borne by owners of less valuable parcels, but in the long run the parcel tax may be capitalized in the price of real

estate—meaning that it will affect the demand for real estate, so that purchasers of expensive parcels pay in increased mortgage bills what they save in reduced property taxes. Hotel taxes are likely to be progressive taxes on average, insofar as high income people are more likely to book more, and more expensive, hotel rooms. General sales taxes are likely to be regressive.

Who pays the price for property tax limitation is not completely clear. But given these patterns, it seems likely that the net cost of lost public services is likely to outweigh the value of the tax savings for younger parents, especially if they rent or if they own homes purchased before the real estate bubble burst.

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[1] E.g., Phuong Nguyen-Hoang, "Tax Limit Repeal and School Spending," *National Tax Journal* 66, no. 1 (2013): 117-48, finds that a 1949 limitation on the average effective property tax rates of small city school districts in New York State did not actually constrain the growth of district revenues or spending. In an influential article, Philip Joyce and Daniel Mullins classified such early property tax limits as "nonbinding" because they did not cap the growth of assessed values or total revenues. See Joyce and Mullins, "The Changing Fiscal Structure of the State and Local Public Sector: The Impact of Tax and Expenditure Limitations," *Public Administration Review*, 51 (3): 240-53.

[2] See, e.g., Anne E. Preston and Casey Ichniowski, "A National Perspective on the Nature and Effects of the Local Property Tax Revolt, 1976-1986," *National Tax Journal* 44 (1991): 123–45; Ronald J. Shadbegian, "Do Tax and Expenditure Limitations Affect Local Government Budgets? Evidence from Panel Data," *Public Finance Review* 26, no. 2 (1998): 118–36; Ronald J. Shadbegian, "The Effect of Tax and Expenditure Limitations on the Revenue Structure of Local Government, 1962-1987," *National Tax Journal* 52 (1999): 221–37; Mark Skidmore, "Tax and Expenditure Limitations and the Fiscal Relationships Between State and Local Governments." *Public Choice* 99, no. 1-2 (1999):77–102; Richard F. Dye and Therese J. McGuire, "The Effect of Property Tax Limitation Measures on Local Government Fiscal Behavior." *Journal of Public Economics* 66 (1997): 469–87;Changhoon Jung and Suho Bae, "Changing Revenue and Expenditure Structure and the Reliance on User Charges and Fees in American Counties, 1972-2002." *The American Review of Public Administration* 41, no. 1 (2011): 92–110; William H. Hoyt, Paul A. Coomes, and Amelia M. Biehl, "Tax Limits and Housing Markets: Some Evidence at the State Level." *Real Estate Economics* 39, no. 1 (2011): 97–132; Nathan B. Anderson, "No Relief: Tax Prices and Property Tax Burdens." *Regional Science and Urban Economics* 41 (2011): 537–49; Ellen Seljan, "The Limits of Tax and Expenditure Limits: TEL Implementation as a Principal-agent Problem." *Public Choice* 159 (2014): 485–501; Rui Sun, "Reevaluating the Effect of Tax and Expenditure Limitations: An Instrumental Variable Approach," *Public Finance Review* 42, no. 1 (2014): 92–115.

[3] See Arthur O'Sullivan, Terri A. Sexton, and Steven M. Sheffrin, *Property Taxes & Tax Revolts* (Cambridge University Press, New York, 1995); David R. Doerr, "The Evolution of Proposition 13," pp. 71-88 in Jack Citrin and Isaac William Martin, eds., *After the Tax Revolt: California's Proposition 13 Turns 30* (Berkeley Public Policy Press, Berkeley, 2009).

[4] O'Sullivan, Sexton, and Sheffrin, *Property Taxes & Tax Revolts*, found that the tax savings from Proposition 13 in California disproportionately accrued to low-income homeowners, who were overrepresented among long-term homeowners. By contrast, Mark Skidmore, Charles L. Ballard, and Timothy R. Hodge, "Property Value Assessment Growth Limits and Redistribution of Property Tax Payments: Evidence from Michigan." *National Tax Journal* 63, no. 3 (2010): 509–38, found that tax savings from assessment limitation in Michigan accrued disproportionately to upper-income homeowners; and Richard F. Dye, Daniel P. McMillen and David F. Merriman, "Illinois' Response to Rising Residential Property Values: An Assessment Growth Cap in Cook County," *National Tax Journal*, 49, no. 3 (2006): 707-16, found that the tax savings from a homestead assessment cap in Cook County, Illinois, bore no relation, positive or negative, to average income measured at the neighborhood level.

[5] O'Sullivan, Sexton and Sheffrin, *Property Taxes and Tax Revolts*, computed the tax savings from Proposition 13 by comparing aggregate assessments to aggregate sales price data of comparable homes. Dowell Myers, "The Demographics of Proposition 13: Large Disparities Between the Generations and the Unsustainable Effects of House Prices." Working paper, USC School of Policy Planning and Design, Population Dynamics Research Group, 2009, computed the tax savings from survey self reports of property tax and home values by California respondents to the American Housing Survey; Skidmore, Ballard and Hodge, "Property Value Assessment Growth Limits," computed effective property tax rates of more and less recent home buyers from a survey of Michigan residents. All three studies conclude that the greatest tax savings from assessment limitation accrue to elderly homeowners, because the elderly are most likely to have purchased their homes long ago. They differed on the incidence by race: Myers computed that the average tax savings enjoyed by non-Hispanic white homeowners in 2007 were on average 1.2 times the tax savings enjoyed by black homeowners, and 1.4 times those enjoyed by Latino and Asian homeowners, who on average bought their homes most recently; but Skidmore, Ballard and Hodge found no statistically significant gap in tax savings between black and white homeowners in Michigan.

[6] Sun, "Reevaluating the Effect of Tax and Expenditure Limitations," finds that the presence of a local tax and expenditure limit (a general policy category that includes property tax limits) is associated with more county sales tax revenue per capita and more county income tax revenue per capita, but the signs and magnitudes of the coefficients are sensitive to the choice of instrumental variables. Matthew D. McCubbins and Ellen Moule, "Making Mountains of Debt Out of Molehills: The Pro-Cyclical Implications of Tax and Expenditure Limitations." *National Tax Journal* 63, no. 3 (2010): 603–22, find that property tax levy limits decrease the property tax share, decrease the sales tax share, and increase the income tax share of combined state and local revenues.

[7] Douglas C. Bice and William H. Hoyt, "The Impact of Mandates and Tax Limits on Voluntary Contributions to Local Public Services: An Application to Fire-Protection Services." *National Tax Journal* 53, no. 1 (2000):79–104; Mark M. Glickman and Gary D. Painter, "Do Tax and Expenditure Limits Lead to State Lotteries? Evidence from the United States: 1970-1992." *Public Finance Review* 32, no. 1 (2004): 36–64. Shadbegian, "The Effect of Tax and Expenditure Limitations...", finds that local governments in states with property tax limits report more non-tax income per capita. Tom Downes and Kieran M. Killeen, "So Slow to Change: The Limited Growth of Nontax Revenues in Public Education Finance, 1991-2010," *Education Finance and Policy* 9, no. 4 (2014) 657-99, find that property tax limitation increases school districts' reliance on only some some categories of fees and non-tax revenues. Skidmore, "Tax and Expenditure Limitations," and Sun, "Reevaluating the Effect of Tax and Expenditure Limitations", both find that property tax limitation is positively correlations with per capita user fees, while Jung and

Bae, “Changing Revenue and Expenditure Structure”, find a negative correlation, but none of these are statistically significant.

[8] Shadbegian, “The Effect of Tax and Expenditure Limitations”; Mark Skidmore, “Tax and Expenditure Limitations”; Hoyt, Coomes, and Biehl, “Tax Limits and Housing Markets”; Sun, “Reevaluating the Effect of Tax and Expenditure Limitations.”

[9] Preston and Ichniowski, “A National Perspective”; Shadbegian, “Do Tax and Expenditure Limitations Affect Local Government Budgets?”; Shadbegian, “The Effect of Tax and Expenditure Limitations”; Skidmore, “Tax and Expenditure Limitations”; Jung and Bae, “Changing Revenue and Expenditure Structure.”

[10] Dye McGuire, “The Effect of Property Tax Limitation Measures”; Anderson, “No Relief”; Hoyt, Coomes and Biehl, “Tax Limits and Housing Markets”; Shadbegian, “Do Tax and Expenditure Limitations Affect Local Government Budgets?”; William F. Blankenau and Mark L. Skidmore, “School Finance Litigation, Tax and Expenditure Limitations, and Education Spending,” *Contemporary Economic Policy* 22, no. 1 (2004): 127–43; Richard F. Dye, Therese J. McGuire, and Daniel P. McMillen, “Are Property Tax Limitations More Binding over Time?” *National Tax Journal* 58, no. 2 (2005): 215–25; Katharine L. Bradbury, Christopher J. Mayer, and Karl E. Case, “Property Tax Limits, Local Fiscal Behavior, and Property Values: Evidence from Massachusetts Under Proposition 2 1/2.” *Journal of Public Economics* 80 (2001): 287–311; Daniel P. McMillen and Larry D. Singell Jr., “A Distributional Difference-in-Difference Evaluation of the Response of School Expenditures to Reforms and Tax Limits.” *Education Finance and Policy* 5, no. 3 (2010): 349–77.

[11] Charles W. Kadlec and Arthur B. Laffer, "The Jarvis-Gann Tax Cut Proposal: An Application of the Laffer Curve," in *The Economics of the Tax Revolt: A Reader*, ed. Arthur B. Laffer and Jan B. Seymour (New York: Harcourt Brace Jovanovich, 1978); Alfred L. Malabre, Jr., "Tax-Cut Theorist," *Wall Street Journal*, December 1 1978; Los Angeles Times, "Reagan Believes Prop. 13 Will Spark Tax Revolt," *Los Angeles Times*, June 24 1978.