Vol. 84 No. 6 December 2008

The Virginia News Letter

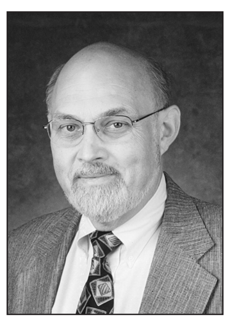
Property Tax Relief: Why Virginia Should Adopt A State-Funded Income-Targeted Approach

By John H. Bowman

The property tax has never been popular and the recent housing-market boom raised the level of discontent another notch or two. The bursting of the housing bubble may have reduced the urgency of the issue at present. Considering property tax relief is desirable because, unlikely as it may seem during the current housing crisis, there will be another period of rapidly escalating prices in the future; moreover, property tax relief of the sort proposed here can provide needed assistance to people squeezed by reduced income in periods of economic slack. There are also other reasons to have a sound property tax relief policy in place.

This article will examine the role and nature of the residential property tax, ways to make it fair and effective, and various forms of tax relief. It will then focus on the "circuit breaker" form of relief, designed to prevent an overload of property taxes, just as an electrical circuit breaker protects against an overload of current. Such relief, pioneered by Wisconsin four decades ago, now is found in two-thirds of the states.

Some comparatively minor changes to address problems in the property tax are desirable and feasible. Moreover, this limited course of action is preferable to more fundamental changes to the tax and certainly better than seeking to eliminate it, a move proposed recently in some states.



John H. Bowman

Property Tax Role and Nature

The property tax's history spans many centuries and continents, and it is the oldest broad-base tax in the United States.

Property Tax Pros and Cons.

Some strengths of the real property tax include:

(a) Because the real property tax base is relatively immobile, local tax differences are less likely to affect the location of economic activity across localities.

(b) The tax base is more readily identified, valued, and taxed than some income and consumption taxes, and this facilitates administration.

(c) The tax is paid in one or a few comparatively large payments over the course of the year, and thus is more visible—i.e., taxpayers are more aware of the costs they bear for government services than they are under other taxes.[1] This makes

[1] Property owners get property tax bills telling them how large their tax liabilities are. In contrast, sales taxes are paid a little bit at a time and are not noticed as much; most people probably do not have a very good idea of what their sales tax payments total over the course of a

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for more realistic and responsible voter decisions on government budgets.

(d) The base is less prone to pronounced swings from year to year, and thus provides local governments with a more stable and predictable source of revenue.

(e) The tax base correlates relatively well with both benefits received from government services and ability to pay for such services.

Some weaknesses and sources of complaint about the real property tax include:

(a) Too often administration is poor and produces assessed values that do not represent a reasonably constant percentage of market values across properties, causing allocation of tax burdens to be capricious and unfair.

(b) The tax is on accumulated asset value rather than current economic flows (such as income and consumption), so tax burdens for some can be large in relation to current income for various reasons.

(c) Because taxes are paid in one or a few relatively large installments, people are more aware of their property tax liabilities and more likely to complain about them.

A more positive reason for keeping the property tax is its vital role in meaningful local self-government; keeping government "close to the people" is a cherished ideal in this country.

Major Financing Role. The property tax is not only theoretically better suited to local use than other broad-base taxes, but in practice it is far and away the largest source of locally raised tax dollars. In 2005-2006, the latest year for which comparable data are available for all states, property taxation accounted for 71.7 percent of local taxes nationally and 71.6 percent in Virginia. State and local governments taken together raised $359 billion from property taxes, compared to $282 billion from general sales taxes, $269 billion from individual income taxes, and $53 billion from corporate income taxes.[2] In Virginia, state and local governments raised $9.2 billion from property taxes, $4.3 billion from general sales taxes, $9.1 billion from individual income taxes, and $0.8 billion from corporate income taxes.

The sheer magnitude of property tax revenue reveals a key reason this tax continues, despite discontent. In Virginia, the individual income tax would have to be doubled, while replacing property taxes with sales taxes would require more than trebling the combined state and local general sales tax rate, now at 5 percent. A more positive reason for keeping the property tax is its vital role in meaningful local self-government; keeping government "close to the people" is a cherished ideal in this country. Other major taxes are less suited to local control, and increased state levies to replace property tax revenue with increased state aid would seriously weaken meaningful local self-government.

Strengthening the Property Tax

Some improvements in the tax go hand-in-hand with consideration of tax relief.

Poor Administration Can Be Overcome. A major complaint has been poor administrative performance in getting assessed values to a uniform level of market value. That still is a problem in too many areas, but modern technology has made good assessment administration a reality in many places—including many Virginia cities and counties—and it is an attainable objective in the others. That technology includes computerized property records and now, increasingly, comprehensive geographic information systems. Both improve valuation accuracy by taking more value-influencing factors into account in a systematic manner. This approach also is more economical than older, more labor-intensive valuation methods. Localities with annual reassessment are more likely to meet and even exceed the primary generally accepted standard for gauging assessment accuracy and fairness.[3]

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year. Withholding makes income taxes less visible—or at least less painful—than the property tax; indeed, how happy or unhappy people are with the income tax often seems to rest largely on whether or not they get a refund or have to make an additional payment at the time of annual filing.

[2] The Bureau of the Census, which compiles the data, does not publish separate details on types of property tax. Therefore, for Virginia, the bureau's data on property taxes included real property taxes, public service corporation property taxes, the personal property tax, the machinery and tools tax, and the merchant's capital tax. U.S. Bureau of the Census, Federal, State, and Local Government Finances http://www.census.gov/govs/www/estimate.html (10/6/08)

[3] That measure, the coefficient of dispersion (CD), is derived from annual assessment-sales ratio studies. For sold properties, the ratio of assessed value to sale price is calculated; the CD expresses the average absolute deviation of individual-property ratios from the median ratio, as a percentage of the median ratio; lower values indicate more uniform assessment levels and more uniform assessments allocate the tax across properties more fairly. A CD of 15 is acceptable for most residential properties with a CD of 10 or less for newer or more homogeneous areas. See: International Association of Assessing Officers, *Standard on Ratio Studies* (Approved July 2007), p. 17. http://www.iaao.org/documents/index.cfm?&Category=23 (11/6/2008). For 2006, some 16 Virginia localities (8 cities and 8 counties), including populous Fairfax County, had CDs under 10 for sales of all property types, which are dominated by single-family residential sales; of the total, 13 had annual reassessments and the other three had just been reassessed. An additional 23 localities (13

Keeping Assessments Current Is Vital. The property tax is a levy on the value of property owned. Fairness requires that taxable values be kept abreast of market developments through frequent reassessment; otherwise there is no consistent relationship between tax liability and property value—and inequity reigns. Increased assessments tend to be unpopular because they generally are associated with higher tax liabilities. This need not be the case, because tax liabilities are the product of tax rate times tax base value. Assessment officials are responsible for accurate determination of taxable values (assessed value, the statutory tax base). Tax rates are set by city councils and county boards of supervisors, and they can adjust rates downward when the tax base rises; however, often the rate reduction is not commensurate with the assessment increase.[4] The desire for revenue growth beyond that generated by new construction and improvements often is understandable and quite legitimate, but when officials claim there has been "no tax increase" they badly distort the facts because the nominal tax rate is not a good measure of the level of the tax since it provides only part of the needed information.

While there are upward pressures on the property tax, its growth over the last quarter-century has roughly matched the growth in personal income, and it has fallen as a percentage of personal income from about 4 percent in the 1960s and 1970s to about 3 percent since the early 1980s, although it has risen slightly since 2002. In fiscal year 2006, property taxes were equal to 3.27 percent of personal income nationally and 3.13 percent in Virginia.[5] Data relating individual households' property tax liabilities to their incomes are not readily available, but a recent study in Maine found that while the gross property tax bill (before relief) represented less than 3 percent of income for more than 35 percent of the state's households, property taxes amounted to more than 20 percent of income for over 5 percent of the households.[6]

In the recent housing-market boom, widespread and large increases in assessed values that were not fully offset by nominal tax rate reductions produced tax revolts around the nation. Many states adopted measures to restrict the rate of increase in assessed values and/or tax bills, particularly for owner-occupied residences. Efforts to actually reduce or even eliminate property taxes were made in some states.[7]

Well-Designed Property Tax Relief Can Deal with Tax-Related Hardships. While administrative reform can help with inequities resulting from infrequent or inaccurate reassessment, there remains the problem of the cash-flow crunch for homeowners that can result from the nature of the property tax. Carefully structured property tax relief is needed to deal with these problems. There are important differences among property tax relief measures; some undermine the logic of property taxation, creating inequities even though their proponents intend improved fairness. Property taxes are levied on asset values, and that basic principle must be kept in mind. Wholesale departure from this principle makes the "property tax" something other than a tax on property value. Property tax bills, even within a single taxing jurisdiction with a single nominal tax rate, may then vary considerably more across taxpayers than the differences in their property values; the tax, as actually implemented, becomes a levy with no underlying logic to guide tax policy decisions. It becomes a property tax in name only, as tax liabilities come to depend more on political clout, or influence—or the lack of political influence—with no systematic relationship to property value.

An Overview of Residential Property Tax Relief

For over 30 years, every state has made some provision for property tax relief. Virginia differs from other states by making all real property tax relief available at local option and with local funding.

There are important differences among property tax relief measures; some undermine the logic of property taxation, creating inequities even though their proponents intend improved fairness.

cities and 10 counties) had CDs between 10 and 15. Virginia Department of Taxation, *The 2006 Virginia Assessment/Sales Ratio Study* (Richmond: 2008), Table 1, pp. 8-10) http://www.tax.virginia.gov/site.cfm?alias=SalesRatioStudies (10/6/08).

[4] Virginia's "truth in taxation" law (Code reference 58.1-3321) attempts to make clear that this is a tax increase, even if the nominal rate is cut a bit, so citizen inattention is partly to blame for tax increases after reassessment.

[5] These percentages are based on Census Bureau 2005-2006 tax collection data and personal income averages for calendar years 2005 and 2006 reported by the Bureau of Economic Analysis.

[6] Michael Allen and Richard Woodbury, "Containing the Individual Burden of Property Taxes: A Case Study of Circuit Breaker Expansion in Maine." *National Tax Journal*, 59 (September 2006): 665-83.

[7] In South Carolina, for example, a 2006 grass-roots effort resulted in eliminating the property tax for school operating budgets (replaced by a sales tax increase) and capping assessment increases at 15 percent. Elimination of property taxes also has been proposed in Georgia and Indiana.

Perhaps the worst variable to use in targeting property tax relief is the rate or amount of increase in assessed value, but unfortunately this approach spread to more states during the recent housing-market boom.

The Basic Concept. Residential property tax relief goes by several names and takes various forms; some are quite similar despite different names, but some forms that go by the same name have different effects (for example, "homestead exemptions" in one state may exempt a constant amount and in another a constant percentage).[8] For current purposes, it is more useful to think in terms of different possible relief strategies, outlined below:[9]

- Provide relief to all homeowners and renters
  - Relieve tax on uniform percentage of value
  - Relieve tax on uniform amount of value
- Target relief to select homeowners and renters
  - Target on basis of age
  - Target on basis of income
  - Target on basis of rate of increase in home value

Renters as well as homeowners pay property taxes. Although they do not receive property tax bills, the tax generally is part of the rent payment; over time, landlords must be able to recoup their costs or they will not be willing to provide rental housing. In thinking about the need for property tax relief, therefore, it is appropriate to consider the burden of the tax on renters who, as a group, are less well off than homeowners.

Across-the-board property tax relief is wasteful and often ineffective, if the objective is to address the problem of hardships created by property taxes. Most households do not need property tax relief, and scattering relief broadly either runs up the cost needlessly or dilutes the relief so that those truly in need do not get a meaningful amount. This is particularly true for uniform-percentage homestead exemptions (for example, where relief equals tax on 25 percent of value); a large portion of such relief goes to owners of more valuable homes who, in general, are likely to be less in need of tax relief.

Targeting tax relief can provide more relief for those most in need at a lower overall cost than non-targeted relief. Income is a more reasonable targeting variable than either age or rate of increase in home value. Many property tax relief programs are for the elderly only, and many others that include all ages provide more generous relief to the elderly. Such practices are inappropriate. Age is not a good proxy for need; in fact, poverty rates are lower for the elderly than for the non-elderly.[10] In addition, net worth is greater for the elderly than for the non-elderly; older people are more likely to own their homes and to have accumulated other assets.

Perhaps the worst variable to use in targeting property tax relief is the rate or amount of increase in assessed value, but unfortunately this approach spread to more states during the recent housing-market boom. Most homeowners probably do not like to have their assessed values rise if the increase is expected to result in increased property tax liability, but most do not suffer financial hardship as a result. Indeed, people whose home values are rising are made better off by the increase in their net worth; people generally desire rising home values because of this, and prefer to locate in areas where good growth is likely. These gains in home value are windfall gains. They result from government and other societal actions, such as improved transportation, good public schools, parks, and so forth, as opposed to the actions of the individual property owners. Property value gains are not unwanted, but higher property tax bills are, so people clamor for protection from property tax increases when home values rise rapidly. Such relief is provided by caps on either the assessed value or, allowing assessed values to rise with market forces, the tax bill itself. Such programs target property tax relief to homeowners experiencing the most rapid growth in home values, which is to say, increases in wealth—increases for which they are not responsible. It is perverse and preposterous to lavish tax-relief dollars on people being made wealthier by government and societal actions. Moreover, such caps can increase property tax non-uniformity and inequity to a very significant extent in a comparatively short period of time.[11]

Targeting property tax relief by income using the circuit breaker approach can direct relief dollars to where they are most needed. Maine data cited earlier show that property taxes vary widely

[8] John H. Bowman, "Residential Property Tax Relief Measures: A Review and Assessment," in *Erosion of the Local Property Tax Base: Trend, Causes, and Consequences*, ed. Nancy Y. Augustine, Michael E. Bell, and David Brunori. (Cambridge, MA: Lincoln Institute of Land Policy, forthcoming).

[9] John H. Bowman, "Property Tax Policy Responses to Rapidly Rising Home Values: District of Columbia, Maryland, and Virginia." *National Tax Journal*, 59 (September 2006): 717-33.

[10] U.S. Census Bureau. 2008. "POV01: Age and Sex of All People, Family Members and Unrelated Individuals Iterated by Income-to-Poverty Ratio and Race: 2007, Below 100% of Poverty—All Races." http://pubdb3.census.gov/macro/032008/pov/new01_100_01.htm (10/29/2008).

[11] A recent study used a massive Florida database to study the effects of caps on tax increases due to reassessment and found they increased tax non-uniformity markedly. Jennings Wayne Moore, *Evaluating Property Tax Equity Implications of Capping Assessment Increases: Evidence from Florida.* (2008) Ph.D. dissertation submitted to North Central University, Prescott Valley, AZ.

in relation to income across households. This comparatively narrow form of property tax relief can provide meaningful relief where it is needed at lower total cost than programs that scatter relief more broadly. Another benefit of the income-targeted approach is minimal departure from the logic of the property tax. Tax fairness and circuit breakers are discussed below.

Gauging Property Tax Fairness. The best gauge of property tax burden is the effective property tax rate, which expresses property tax liability as a percentage of market value. Without property tax relief, and with accurate assessment,[12] effective property tax rates (ETRs) would be the same for all property parcels within a single taxing area. This would indicate that property tax liabilities are determined by property values, consistent with the logic of the tax as a tax on asset value. Property tax relief changes effective property tax rates; properties with tax bills reduced by tax relief will have lower ETRs than properties receiving no relief. The resulting ETR differences indicate inequities—departures from the pure logic of the tax. Thus, even though property tax relief proponents argue that relief improves fairness, relief creates a form of inequity. Because there are some instances in which relief is warranted—the full tax would create an undue hardship—some differences in ETRs across properties must be accepted if relief is granted. That said, care must be taken in designing property tax relief to assure that the determinants of tax relief produce defensible ends. Well-targeted property tax relief, based on need, should produce more uniform overall effective rates than relief that is more widespread and capricious.

If relief is provided for some types or uses of property and not others, effective property tax rates will differ across property use classes. For example, if all real property in a given city is taxed at 1 percent but owner-occupied residences are assessed at 80 percent of market value (a 20 percent homestead exemption) while all other real property is assessed at 100 percent of value, the effective rate is 0.8 percent for homestead residences and 1.0 percent for other use classes. In this example, the effective rate within the homestead class is intended to be equal; tax differences reflect property value differences, preserving the logic of the tax within each class, albeit not across classes.

Some forms of residential property tax relief, however, create different effective tax rates within the residential class. An example is a homestead exemption equal to a constant amount, such as $25,000, for all properties in the class. Because $25,000 is a larger percentage of market value for a $100,000 property than for a $500,000 property, this relief approach will provide a larger tax break (and a lower ETR) for lower-value properties than for higher-value ones. The within-class differences in ETRs might be promoted because the constant-amount exemption provides greater tax relief (in percentage terms) for lower-value properties and thus directs more of the total tax relief budget to those who generally will be in greater need of tax relief.[13]

This is in stark contrast to the differences in ETRs across houses that result from capping assessed value increases (or tax increases) at, say, 5 percent per year. Not all counties and cities experience the same rate of appreciation in home values, and even within a single jurisdiction, some neighborhoods gain value more rapidly than others. Thus, the tax or assessment cap provides larger benefits for some homeowners than for others—nothing for those in an area where market value increases at an annual rate of 5 percent or less, and quite a lot for homeowners where values are growing at a rate of 20 percent. Because of this, ETRs will differ across homeowners under a capping policy. Unlike the ETR differences created by a constant-amount homestead exemption, though, the differences caused by capping provide a perverse subsidy. The increases in market value make the homeowners better off, and the gains are windfall gains created by market forces and societal actions, rather than by actions of the individual homeowner. Thus, market-value growth is a windfall gain for the homeowner fortunate enough to have appreciating property, but capping tax or assessment increases treats these people as victims and reduces their property taxes, taxing them more lightly than homeowners not enjoying such windfall increases to their net worth.

Well-targeted property tax relief, based on need, should produce more uniform overall effective rates than relief that is more widespread and capricious.

[12] Perfectly accurate assessment would have all properties assessed at the same percentage of market value—whether that is 100 percent or some other figure—which would result in a coefficient of dispersion (CD) of zero.

[13] The constant-amount approach may also result in a lower overall cost of property tax relief than a constant-percentage exemption, if relief is set at a high enough level to be meaningful for those most in need. For example, if those most in need are households with a house with a value of $100,000 or less and in general they are thought to need 20 percent tax relief, a $20,000 across-the-board homestead exemption will cost less than a 20 percent exemption.

Large concentrations of households needing relief within a jurisdiction having comparatively low per capita fiscal capacity can make meaningful locally financed property tax relief impossible.

Virginia Residential Property Tax Relief, 2007

With no statewide or state-funded real property tax relief, Virginia authorizes local governments to grant relief to elderly (aged 65 and over) and disabled homeowners, either as a homestead exemption (where some portion of the tax base is ignored in calculating the tax) or as a tax deferral. Income and net worth ceilings are set within state-prescribed limits.

Property tax relief measures have been adopted by 123 of the 134 counties and independent cities and also by many towns.[14] Most localities structure their relief programs as circuit breakers (discussed below), with relief falling as income rises, and most provide exemption rather than deferral; several, however, combine exemption and deferral, and exemption commonly is provided in the manner of a sliding-scale circuit breaker.

Recently, a few localities have gained authority to offer property tax relief—housing "grants"—to some homeowners who are not elderly or disabled. Alexandria's grants range from $200 to $1,200, depending on income (up to a $100,000 maximum). Charlottesville provides up to $500 for homeowners with income below $50,000 and homes assessed for less than $350,000.[15]

Circuit Breaker Property Tax Relief

The hallmark of circuit breaker property tax relief is that relief declines as income rises. Some 35 states had circuit breaker programs as of mid-2007.[16]

The Two Main Forms. There are two basic approaches to circuit breaker property tax relief: "threshold" and "sliding scale." Limits typically are placed on tax relief benefits, as well as on the claimant's income, and sometimes on net worth.

• **Threshold approach** - The amount of a claimant's property tax in excess of some percentage of income is eligible for relief. The percentage defines a threshold amount that the tax must exceed before any relief can be received.

Single threshold - Found in nine states in 2007, the single-threshold form is the simplest circuit breaker. The threshold is a single percentage figure; if that figure is 4 percent, for example, a household with $25,000 income is eligible for relief on the amount of property tax in excess of $1,000.

Multiple thresholds - This variant, found in 10 states in 2007, defines several bands of income and assigns a threshold percentage to each income band; the threshold percentage for each bracket is higher than for the one below it, with brackets applied incrementally. For example, Maryland has a zero threshold for the first $8,000 of income, 4 percent for the next $4,000 of income, 6.5 percent for the next $4,000, and 9 percent for the portion of income above $16,000. Thus a household with an income of $25,000 would be eligible for relief on the amount of property tax in excess of $1,230.[17] Such a program causes claimants' effective net property tax rates to rise with income, rather than being leveled to a constant threshold percentage for all claimants, as under a single-threshold formula.

• **Sliding scale** - Under the sliding-scale approach, the property tax does not have to rise above a given level in relation to income before relief is granted. A sliding-scale circuit breaker defines multiple brackets of income and assigns a relief percentage to each bracket, with the relief percentage falling from bracket to bracket moving up the income scale. If the relief percentage for an income bracket is, say, 60 percent, that percentage reduction applies for each claimant in that bracket, whether the initial tax bill was equal to 1 percent or some other portion of income. As a result, this approach may not eliminate "property tax overload" for some claimants.

The Best Form of Tax Relief. I suggest that the best form of residential property tax relief is a circuit breaker that includes seven key features.

(1) State funding. This is important because both the portion of households needing relief and local ability to fund property tax relief differ across localities. Median family income levels and poverty rates, for example, differ widely across the 134 counties and independent cities of Virginia. A higher poverty rate might suggest both a greater need for property tax relief and a lower ability to fund it. Large concentrations of households needing relief within a jurisdiction having comparatively low per capita fiscal

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14 John L. Knapp, William M. Shobe, and Stephen C. Kulp, *Virginia Local Tax Rates, 2007* (Charlottesville: Weldon Cooper Center for Public Service, 2007), Section 3. http://www.coopercenter.org/publications/ECONOMICS/Local%20Taxes.php (10/6/08)

15 Knapp, Shobe, and Kulp 2007, p. 5.

16 John H. Bowman, *Property Tax Circuit Breakers in 2007: Features, Use, and Policy Issues.* Working Paper WP08JB1. Cambridge, MA: Lincoln Institute of Land Policy, 2008. http://www.lincolninst.edu/pubs/PubDetail.aspx?pubid=1355 (10/29/2008)

17 (0 percent x $8,000) + (4 percent x $4,000) + (6.5 percent x $4,000) + (9 percent x $9,000) = 0 + $160 +$260 + $810 = $1,230

capacity can make meaningful locally financed property tax relief impossible.

(2) A threshold formula, preferably of the multiple-threshold variety found in several states. A threshold circuit breaker is able to deal with property taxes that are high relative to income, for whatever reason and over whatever period of time. It can deal with property tax difficulties of retirees whose incomes now are lower than when they were working and with similar problems of unemployed people. A threshold circuit breaker can also provide relief for people who truly are overburdened by rising property taxes due to rising home values, without the large revenue losses and widespread inequities that result from caps on assessment or tax increases.

(3) A very broad definition of income. A threshold circuit breaker targets relief to those most in need of it, as measured by income, better than any other relief mechanism; use of multiple thresholds, incrementally applied, enhances this feature. It is essential, however, that income be defined very broadly. When some sources of income are excluded from consideration, people with income from the favored sources are made to look poorer than they really are, and this distorts the distribution of property tax relief dollars. Income generally is defined very broadly for circuit breakers, but there has been some erosion of the definition in some states. For instance, Social Security recipients often lobby to have this income source excluded from consideration; where they have succeeded, the advantages of targeting property tax relief based on income are lost to a very great extent. An elderly couple can have $50,000 or more in Social Security benefits but appear to be destitute if income from this source is defined away by political decree. Serious inequities result from pretending that some sources of income really do not constitute income.

(4) Coverage of owners and renters of all ages. Coverage of all owners and renters is a matter of simple equity. The standard way of determining renters' property tax payments is to define some percentage of rent as property tax. The relationship between rent and property tax levels in various parts of a state should be studied, to allow a realistic figure to be set. A few states ask renters filing for circuit breaker tax relief to provide the landlord's estimate of the share of property tax actually paid that is attributable to the claimant's housing unit; this alternative should be explored.

(5) State-reimbursed property tax credits for homeowners and state-issued checks for renters. States get circuit breaker relief to claimants in various ways: a direct reduction of the tax bill; a refundable credit under the state income tax; and a separate refund process. If the tax bill is reduced directly, the state then reimburses local governments for the amount of tax reductions received by circuit breaker claimants. A direct reduction has two principal advantages. First, relief is timely. Claimants do not have to pay their property tax bill and wait for a refund or for state income tax filing time. Second, direct reduction of the property tax bill should make it clearer to claimants that they are, in fact, getting property tax relief. Extending circuit breaker benefits through a separate refund or through the income tax runs the risk of people not thinking of the benefits as property tax relief. To the the extent this happens, property tax relief will not reduce unhappiness with the property tax. Because renters do not receive property tax bills, their circuit breaker benefits must be paid differently. Structuring a circuit breaker as a refundable income tax credit is not the advantage it may seem at first blush. Many circuit breaker claimants have too little income to be required to file income tax returns. Moreover, the income definition appropriate for a circuit breaker is broader than the definition used for income taxes, so information not required for the income tax must be collected for the circuit breaker credit.

(6) No income or benefit limits. Limits on income and benefits serve to control program costs, but they are not necessary in a threshold circuit breaker because benefits decline as income rises, eventually falling to zero. In addition, limits can undercut such objectives as assuring that property taxes do not force people from their homes. If limits prove politically necessary (to assure that only "deserving" households receive property tax relief), they should be set at realistic levels and adjusted annually through automatic indexation, based on changes in the consumer price index.

(7) Tax relief determined by considering only the taxes on home value up to some limit. One limit that makes some sense restricts taxes considered for relief to those on only the first few hundred thousand dollars of market value. This can avoid making very large benefit payments to people with very expensive homes, while not excluding people with such homes from possible participation in periods of reduced income. The amount of home value on which taxes will be considered might be set at 1.5 to 2.0 times median home value for either the claimant's local area or for the state as a whole. For example, if

When some sources of income are excluded from consideration, people with income from the favored sources are made to look poorer than they really are, and this distorts the distribution of property tax relief dollars.

the median home value is $225,000 and the multiplier is 2.0, then only the property tax on the first $450,000 of value would be considered.

Using local median values seems desirable in a state such as Virginia, given the differences between the very high home values found in Northern Virginia, and much lower values in some other parts of the state. Either way, linking the limit to median home value effectively indexes this limit. The limit itself makes some benefits potentially available to all residents, should their circumstances render their tax bills excessive relative to income, while at the same time restricting the benefits available to occupants of especially valuable homes. Both these attributes may increase political acceptance and also improve targeting. Moreover, it generally will not cause hardship, as very high home values generally are indicative of wealth, or of equity that may be borrowed against to pay taxes.

Conclusion

A state-funded income-targeted approach to property tax relief—a circuit breaker to protect the homeowner and renter, with certain key features—is a highly effective form. Appropriate definition of income is the most important condition for equitable circuit breaker property tax relief. This means not only that all sources of money income need to be considered, but the numbers have to be current. It is not appropriate to have a claim filed and approved and then require no subsequent determination of income for a period of years. Getting an accurate reporting of income places burdens on both claimants (compliance costs) and administrators (administrative costs) that may not be trivial. In return, however, there are several benefits. Effective property tax relief can be provided to those who truly need it with a lower outlay for tax relief benefits than with other property tax relief approaches. This is because the relief is provided more narrowly, targeted on the basis of income. And because the relief is provided more narrowly, the underlying logic and revenue productivity of the property tax are better preserved.

Virginia should strongly consider joining the large majority of states that already employ this form of property tax relief.

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VOL. 84 NO. 6 DECEMBER 2008

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The Virginia News Letter (ISSN 0042-0271) is published by the Weldon Cooper Center for Public Service, University of Virginia, P.O. Box 400206, Charlottesville, Virginia 22904-4206; (434)982-5704, TDD: (434) 982-HEAR.

Periodical postage paid at Charlottesville, Virginia.

Postmaster: Send address changes to the Weldon Cooper Center for Public Service, P.O. Box 400206, Charlottesville, Virginia 22904-4206.

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The Virginia News Letter

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