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Tax Report: States Move To Cut, Cap Property Taxes

As Home Values Decline, Many Will Have to Make Up Lost Revenue by Other Means

By Martin A. Vaughan

Soaring property values in recent years swelled the coffers of counties and municipalities, raising calls for property-tax cuts. Now, even as foreclosures and dwindling home sales shrink local tax bases, a number of state governments are slashing or capping property-tax rates.

New York Gov. David Paterson last week launched a bid to make New York the latest state to roll back property taxes. Already this year, statehouses in Indiana and Florida have passed new property-tax curbs.

But many of these property-tax initiatives, while politically popular, mask a hidden truth: They are likely to lead to increases in other kinds of taxes.

So-called "swaps," under which property taxes are cut and made up for by levies elsewhere, have been popular in statehouses. Idaho, South Carolina and Texas passed their own versions in 2006. But even when states don't make such deals outright, they may in the long run resort to tax increases to plug revenue holes.

The national movement against property taxes dates to the 1970s. But the most recent real-estate bubble has given it more potency in certain regions of the country, like the New York City suburbs. Median property taxes paid in New York's Westchester, Nassau, and Rockland counties all ranked in the top 10 nationally for 2006, according to the nonprofit Tax Foundation.

This March, Republican Indiana Gov. Mitch Daniels signed legislation to cut property taxes by an average of 30% and, starting in 2010, to cap the taxes at 1% of assessed value. The state will assume some program costs formerly borne by localities and pay for them by boosting its sales tax to 7% from 6%.

But growth in state sales-tax revenue has slowed to a virtual standstill as consumers adjust to the pain of the housing and credit crunch, according to Nicholas Johnson, director of the State Fiscal Project at the Center on Budget and Policy Priorities. That could lead states to look to tax increases elsewhere to pick up the slack — for instance, by broadening the sales-tax base to tax services like health-club memberships or spa services, he said.

That is exactly what critics of new property-tax curbs in Florida are afraid of. Politicians "did not fully appreciate the $11 billion bill left to state governments, which is going to require unprecedented tax increases or cuts in services," says Dominic M. Calabro, president and CEO of Florida TaxWatch, a nonprofit taxpayer group representing businesses and individual taxpayers.

Florida voters in January amended the state's constitution to further limit property taxes. The state has long protected "homesteaders," or Floridians who live in their houses for more than six months of the year, by limiting the increase in the assessed value of their homes to 3% annually. In January, voters built on those limits. Over time, the difference between the assessed value and the market value of homesteaders' properties becomes substantial; the new measure ensures that homesteaders who move to a new home won't lose the tax benefits they've built up in their old home.

Such changes are already putting the squeeze on Florida school jurisdictions, which may tap "snowbirds" — retirees who live in the state only part of the year — to make up lost revenues. Those out-of-state property owners aren't eligible for most of Florida's property-tax protections.

Mr. Calabro is most critical of a Florida proposal on the ballot this November that would further roll back property taxes and increase state sales taxes to do so. With no state income tax, Florida relies on its 6% sales tax to a larger degree than any state save two — Washington and Tennessee.

Florida, rocked by the subprime crisis and its spillover effects on the tourism industry, already has resorted to deep budget cuts in each of the last two years. Mr. Calabro said it is extremely unlikely that further budget cuts will be used to make up the $11 billion cost of the property-tax ballot initiative — meaning that, ultimately, other taxes will rise.

Another caution for taxpayers: A decline in home values doesn't necessarily translate into a drop in property taxes assessed. Most local tax authorities still have the discretion to boost property-tax rates if they want to raise revenue in the face of a decline in home values. Also, house reassessments take time and don't always reflect the full drop in a house's market value.

Donald Boyd, a senior fellow at the State University of New York's Rockefeller Institute of Government, studied the impact of some recent housing busts on property-tax collections. He found that in such areas as Austin, Texas, and Grand Junction, Colo., property-tax collections saw yearly increases of up to 20% for years after home values had begun to drop. Tax assessments in most cases leveled off, but did not drop in proportion to the home-value decreases.

One solution: Be vigilant, and be prepared to appeal your property-tax assessment.

"Most of my clients are asking that we pay particular attention to property taxes this year," says Whitney Compton of Georgia-based Compton and Associates LLP, a tax-advisory firm. "The resistance from assessing authorities is considerably stronger with respect to commercial and industrial property, because businesses don't vote," he said.

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AS STATES START to tighten belts, legislators are looking to some tried-and-true revenue sources.

Levies on cigarettes and booze are often the preferred tax of first resort for cash-strapped states that have new programs to fund, and 2008 was no exception. New York and New Hampshire enacted cigarette-tax increases, while South Carolina's Gov. Mark Sanford vetoed a proposed 50-cent-a-pack increase to fund a new health-care program.

Another sign of painful fiscal times, according to Verenda Smith of the Federation of Tax Administrators, is tax-amnesty programs where states offer to temporarily waive interest and/or penalties for delinquent taxpayers. It is a quick way to raise cash, even though states may lose a little in penalties and interest in the long run.

Nevada Governor Jim Gibbons last week announced an amnesty period starting July 1 and stretching to September 30. It applies to business taxes; Nevada has no individual income tax. But other states can't be far behind. "They come in waves," says Ms. Smith.