

PROPERTY TAX

-- a study in discrimination --

..by Richard R. Gideon

In North America the major vehicle for funding local governments and school districts is the property tax. This tax is calculated on the value of real property, based either on the actual sale price of the property, or on a calculation made by an assessment professional. The percentage rate may be applied to the entire value of the property, or it might be applied to a fraction of the actual value or assessed value. The assessor may be a contract professional, or a salaried employee of a government entity, such as a county. Real property is usually land and the improvements made thereon, but in some places it also includes automobiles, boats, and sundry personal property. This paper aims solely at land and the improvements thereon, such as houses, barns, cultivated fields, etc.

Taxing property is as old as recorded history, going back at least six thousand years. Clay tablets found in the ancient city of Lagash, in Iraq, bear witness to the systematic imposition of taxes.¹ Usually the tax was an “in kind” payment, such as a percentage of food gleaned from the land. But before we can go further in our study of the property tax we must digress a bit and consider the issue of government itself.

THE PARABLE OF THE DAWN OF THE TAX MAN

In the mists of time, back before writing or even the development of language, when a human being was born his entire life was consumed by the struggle to get something to eat and to keep from being eaten himself. In order to get something to eat a prehistoric man could kill an animal and gather grains or any other “vegetable” product that would not kill him, or he could simply wait for some other prehistoric man to do those things and then take what he wanted. If he was strong enough, or crafty enough, the latter method was the easiest.

Eventually – and just how or when no one will ever know – man decided that he could plant some of those grains or nuts or whatever and by doing so give himself a relatively reliable source of food and eliminate a lot of moving around. He could site his fields near streams, and have both food and water available. He could also subdue some of the animals he liked to eat and keep them at hand as well. Once his food situation was settled a prehistoric man could direct his efforts to the other activity that occupied his time – making other prehistoric humans.

But creating stationary feeding areas had a down side. Since humans instinctively took what they wanted a fixed location invited easy pickings. Humans still on the move would come into the habitat of the stationary humans, kill them, take everything, and they would do so without remorse because that emotion didn't exist. Anon, the stationary humans figured out that fighting back as a group, and on ground located away from their “community,” could, upon occasion, thwart the marauders. For their part, the marauders figured out that if they killed off everybody and took everything there would be nothing to pillage the next time they called. And then something brilliant happened. Just about the time that language was developing, and perhaps writing along with it, the two sides had a conference. It was decided that the marauders would only take a certain amount of food from the stationary humans and let some

of them live. This would insure a constant supply of goodies for the marauders and less disruption for the stationary humans. Voila! - the first tax system. Unfortunately, this didn't always work. Some marauders did not get the word, and they killed everybody and took everything anyway.

In time some stationary communities became so large that attacking them was deemed unwise. These large communities had discovered the benefits of having some humans farm, some fight, and some figure. The "figuring" group became the government, and the fighting group became the army. Since the figuring group and the fighting group weren't available to farm all the time, but still needed to eat, the figuring group (government) decided to adopt the marauders' "protection racket" plan; but this time it was sold to the farmers as being "for your own good." For their part, the farmers saw the benefits of having perpetual protection available and went along with it. When times were peaceful the figuring group didn't need to take much from the farmers, and many in the fighting class took up farming. But in times of conflict the amount of tax required of the farmers was much more.

Then, at the dawn of recorded history, Og, the Ancient Accountant, discovered the "Law of Diminishing Returns." He observed that if the head "figurer," now called a "king," demanded a lot of tax during times of peace the amount collected would initially spike, but would subsequently drop, often dramatically. This discovery changed the world as those people knew it. Og, who knew how to write and thus kept records, formulated a rule which stated, "A 0% tax results in no revenue, and a 100% tax does the same!"

THE DISCONNECT

What has stayed remarkably consistent over the centuries from the time the first tax was implemented is that wealth is *related* to the land. What has changed is the relationship between the land and those that live upon it. Up until the beginning of the Twentieth Century and even for some years into it, most people derived their living by farming, raising animals, harvesting timber, and the like. But as more and more people became employees of someone else this relationship changed. Less land was needed to produce more food, and the vast majority of people eating that food were not the ones living on the land. As people started to work in factories they lived on land that was not productive – in single family homes, or apartments owned by someone else. But governments still taxed the land as they always did; not for the in-kind payment of ancient times, but for money. It became irrelevant whether the land was productive in and of itself. It had value because it existed, and those who owned it were required to pay a percentage of its value, usually on a yearly basis.

In North America this disconnect between what the land produced *in fact* and what the government assumed the land was worth has existed since Colonial times. But a farmer might still manage to trade his excess crops for money and pay the tax, as long as the tax wasn't too great. If a farmer didn't own the land he farmed he paid the owner rent out of the land's production, which the landowner used to pay the tax.

By the 1950's in America land usage, wealth produced from land, and land values became fictionalized for a particular class of people – the residential home owner. Mom and dad and their 2.4 children did not live on a farm and were not engaged in farming; they lived in a

suburb, in a house with a mortgage, on land that produced nothing but crabgrass. Dad got in a car every weekday morning and drove five to ten miles to an office or factory whilst the kids went to school and mom cooked. But the local government still taxed the land as if it was producing wealth, although the value of the land was not related to what it actually produced - which was nothing - but rather to what a tax assessor said it was worth.ⁱⁱ This situation created a distortion between the value of land and the tax paid on it. Land was *assigned* value and taxed on it, while the landowner paid the tax out of income that had nothing to do with his property. Thus it is that for residential property that produces no wealth there is no direct connection between the tax assessed and the income of the property owner. In addition, the residential property tax is regressive; as the income of the property owner goes up the percentage of that income needed to pay the property tax goes down. This is why a tax increase to fund various municipal projects is no big deal for the “rich” in any town, but it is a very big deal for those living on pensions. So the most logical question to ask is, “If the property tax is fictitious and creates economic distortions, why do local governments and school districts still look to the property tax as their major funding vehicle?”

IN GOOD TIMES AND IN BAD

The biggest argument adduced by local governments and their school districts in favor of the residential property tax is that property does not move but people do; in other words, it's a reliable tax. The theory is quite simple: By charging tax on the value of property the government is “assured” of income, regardless of the condition of the economy. In good times the tax is paid; in bad times the tax is still paid. Another reason for taxing property, especially at high rates in the “better” municipalities, is that it will attract “the right kind of people.” High income people are often willing to pay high taxes in order to live in places that guarantee no “riffraff” will be around to ruin their day. And if “the right kind of person” should fall on hard times the tax collector will see to it that he is removed by economic necessity and replaced by someone with the ability to pay. The elderly will be encouraged to move out, selling their property to younger, richer, and fertile couples who will keep the system going.

Unfortunately for local governments and school districts, the property tax isn't quite as reliable as it used to be due to vagaries in the economy and the degeneration of some communities. To collect property tax someone has to pay it. If the owner of a property no longer has the assets to pay the bill then the property goes into arrears. A house may sit vacant for a long time and not generate one penny of revenue for the government; after all, it's one thing to hand someone a bill – it's another thing for that bill to be paid. If the property is seized and sold for taxes the local government gets paid, usually with interest, and often the buyer gets a deal; but sometimes the local government puts such conditions on the sale of confiscated property that no person in his right mind will touch it.ⁱⁱⁱ Then there is the time lag between when a tax bill comes due, becomes delinquent, and finally gets paid. One may think that when a property is finally sold for taxes at a Sheriff's Sale and the lost revenue is recovered the local government isn't out anything; but that is generally not the case. There are latent costs involved with yanking property away from its “owner” that the local government cannot anticipate or properly account for in its ledger.

Another problem with the residential property tax is that it encourages local governments and school districts to go into debt. The reason for the debt may be good or bad – that doesn't matter; debt is always something to be given the most sober consideration. A municipality may decide it wants to create more play areas for its residents' children; or a school district may decide to build a new, elaborate (and expensive) high school. On the other hand, a

municipality may find itself facing major infrastructure repairs. If the municipality or school district does not have the cash on hand, and they usually don't, it's all good because they will issue bonds at interest and raise the money to repay the bondholders by raising the real estate tax rate. In good economic times this may not be met with much resistance on the part of the taxpayer, but in bad economic times the usual reaction will be hostile. In order to counter such hostility the municipality might appeal to one's sense of "civic pride" and the anticipation of "increased property values" (maybe yes, maybe no). The school district will fall back onto that old tried and true cliché, "It's for the children" (or more likely for the teachers). These tactics tend to divide residents into "pro" and "anti" government camps, usually ensuring victory for debt.

None of this changes the fact that a person's residential property does not pay anything. Local governments or school districts may do what they want with the tax rate and/or assessments, but the actual figures that matter most are those on paychecks. And paychecks are not a function of the residential property owned by the payee.

Would it be rational to raise local revenue out of local earned income from producers? The answer is a resounding "yes!"; but the likelihood of local politicians turning to that remedy is very small – at the moment.

HITTING A MOVING TARGET

Economists know that there are many methods available to fund local governments and local school districts that are not beholden to the residential property tax. A local tax on incomes is one way of doing it. Many local governments already charge an Earned Income Tax (EIT), usually at modest rates. At first blush it would seem to be a bad idea to shift the burden of funding local governments or school districts from property to income on the grounds that it would harm the wage-earner; but the wage-earner who rents an apartment or owns a home is paying an additional, indirect tax on his income anyway. Incorporated in every rent payment, and in most mortgage payments, is a provision for a real estate tax. And for those wage-earners who don't have an escrow account, the real estate tax bill comes to them nonetheless.

As already mentioned, the residential property tax ends up being an indirect, regressive income tax, since under the property tax system people below the median income level of a given town are paying a higher percentage of their incomes in residential property taxes than the people above the median income level.

Consider, as a case study, the Municipality of Mt. Lebanon, Pennsylvania, which sits about seven miles southwest of downtown Pittsburgh. Known for its tree-lined streets and its "superior" school district, the town was once the home to industrialists, entrepreneurs, and other high-rollers. Today it is home to a large number of retired individuals, highly-paid "public servants," and many lawyers. Mt. Lebanon has weathered the housing crises relatively well, but statistics reveal flat growth in population. In 2000 the population stood at 33,017; in 2010, 33,137.^{iv} The number of young people attending its public schools has been dropping for many years, and most of these young people relocate to more favorable economic (and weather) climates once they graduate out of the local high school and subsequent college or post-secondary schools. People who live in Mt. Lebanon pay a premium for the privilege, as the Municipality has high property taxes. In fact, because the Municipality's school district operates as an independent governmental body, and the County of Allegheny imposes a

property tax as well, Mt. Lebanon residents pay three property taxes; County, Municipal, and School District. In addition, Mt. Lebanon taxes the earned income of its residents, as does the Mt. Lebanon School District.

The following table dramatizes the disproportionate negative effect that property taxes have on income for two families: a median Mt. Lebanon family, and one below the median level:

Family of four – property taxes of 36.08 mils on an assessment of \$227,000.00. *Federal income tax based on a standard deduction of \$11,600 and four exemptions at \$3,700 each (2011). **SSI based on a temporary, 2011 reduction of 2% to 5.65% from the normal 7.65%

Earnings:	\$75,000.00	% of income	\$50,000.00	% of income
Fed*	\$6,440.00	8.59%	\$2,690.00	5.38%
SSIMED**	\$4,237.50	5.65%	\$2,825.00	5.65%
PA	\$2,302.50	3.07%	\$1,535.00	3.07%
ML EIT	\$975.00	1.30%	\$650.00	1.30%
PROP	\$8,190.00	10.92%	\$8,190.00	16.38%
Total taxes	\$22,145.00	29.53%	\$15,890.00	31.78%
	\$52,855.00		\$34,110.00	

The income and assessment figures shown above were based on 2010 data published by the Municipality of Mt. Lebanon, and adjusted for inflation to reflect calendar year 2011. The median income for a family in Mt. Lebanon is \$75,000, and the average home has an assessment of \$227,000.^v ML EIT in the table above stands for Mt. Lebanon Earned Income Tax, which has two components - 0.8% goes to the Municipality, and 0.5% goes to the Mt. Lebanon School District. PROP stands for property taxes, which is calculated on the archaic "millage" system at 100% assessed evaluation or recent sales price. As already mentioned, Mt. Lebanon homeowners pay three property taxes. Thus people living in Mt. Lebanon and owning their homes pay nine (visible) taxes through force of law: Federal Income, Supplemental Security Income (Social Security), Medicare, Pennsylvania State Income, Mt. Lebanon Municipal, Mt. Lebanon School District, Allegheny County Real Estate, Mt. Lebanon Real Estate, and Mt. Lebanon School District Real Estate taxes. In addition to these taxes, Allegheny County residents are subject to payment of a 7% sales tax on qualified items purchased at retail. Since this is a consumption tax, and is controlled by the consumer in terms of whether to purchase an item, it has not been included in the table.

Both example families, as represented in the table, own homes with the same assessed value. This is neither unusual nor out-of-line. One possessed of money is not required to buy more house than one needs, and many people with modest incomes find themselves owning expensive homes due to inflation and rising real estate prices over the years. But one thing stands out in our examples: It is clear that the property tax 1)bears no relation to the income declared in each example, and 2)affects the lessor income the most.

SOLUTIONS?

What could replace the property tax? A direct tax on incomes is more logical than one on non-productive property, although it would certainly be met with resistance. But as we have seen in our example, some local governments impose an Earned Income Tax anyway - and

on top of a property tax. Another solution might be to retain the property tax on PRODUCTIVE property, such as property used for businesses, and impose an income tax on individuals. Yet another, more radical solution is to charge a per-capita tax, augmented by user fees and a real estate tax on productive property. The most radical solution of all is to require that a local government live within its means, providing the essential services appropriate to its station - police, fire, and infrastructure services - and avoiding the kind of long term debt that comes with extravagant projects, such as elaborate high school buildings and sports complexes. But there is hardly the stomach for that kind of thing, as it would require courage on the part of local government leaders to take on the various public sector unions and cartels of special interests; courage that is usually lacking.

The property tax has a long and storied history in the United States, but it has outlived its usefulness, and it is time for it to go.

- i **“A Brief History of Property Tax”** by Richard Henry Carlson, published in the February, 2005 edition of “fair & equitable,” a publication of The International Association of Assessing Officers
- ii Assessing property is only a person's guess at what the property is worth. The only way to establish the actual value of property is to sell it. Therefore, property assessments are fictitious numbers, and regardless of how well-intentioned the assessor may be they cannot be relied upon for anything other than a basis for calculating tax
- iii An example of this may be found in the City of Pittsburgh, which finds itself with a number of what might be considered nice homes on its hands, but unable to sell them for the taxes due because these homes come with huge building code compliance issues.
- iv See page two, "COMPREHENSIVE ANNUAL FINANCIAL REPORT, Fiscal Year Ended December 31, 2010" - published by Mt. Lebanon, Pennsylvania
- v These figures are somewhat transitory, and represent "best guesses" based on figures published by the Municipality of Mt. Lebanon in its Annual Financial Report. However, the figures have a margin of error of +/- 3%, and are therefore useful for making comparisons