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IS THERE REALLY A PROPERTY TAX CRISIS?

JACK NORMAN*

I. INTRODUCTION

The political climate for tax reform in Wisconsin may very well be in the early stage of a fundamental change. Two events in June 2004 are likely, in the long run, to be seen as forerunners of this significant shift. The first event was the collapse of the effort by Republican leaders in the state assembly to force the legislature to vote on the Taxpayer Bill of Rights (“TABOR”) amendment to the state constitution. TABOR aims initially to restrict the ability of state and local governments to increase revenue and ultimately to shrink substantially the scope of government. The second event was the final report of the Governor’s Task Force on Educational Excellence, which called for both an increase in the state sales tax in order to cut local school property taxes and an increase in state support for public education.

The inability of TABOR advocates to move their issue to the floors of the legislature shows a growing sense of skepticism among politicians about simplistic solutions to complex fiscal challenges. The Task Force’s proposals demonstrate a growing awareness that many services performed by state and local government are too essential to be undermined by long-run underfunding. Together, these events suggest that the well-entrenched, antitax fervor may have passed its peak strength.

TABOR is a direct attempt to undermine public services. Modeled originally after a Colorado constitutional amendment by that name, the TABOR movement sought to insert clauses in the state constitution that severely inhibit the growth of government revenue. It would restrict the growth of government revenue in a way that would ultimately cause a vicious cycle: reduced revenue, which leads to reduced quality of service, which leads to reduced public support, which leads to reduced support for taxes. It suffered only a setback in June, not a real defeat, because it means only that the proposal did not move onto the floors of the legislature during 2004. Surely the issue will be aggressively debated in the fall elections and will

* Research Director, Institute for Wisconsin’s Future. This Article is based on a presentation at the Wisconsin Tax Policy Colloquium, Marquette University Law School, April 15–16, 2004.

resurface in the 2005 legislature.

The Governor's Education Task Force is the first public body in several years to call clearly and definitively both for an increase in a major tax (the sales tax) and for an increase in state aid in public education. The Task Force recommendations come just one year after the adoption of a state budget which forced a U-turn in state financial support for public education, by abandoning the state's nearly decade-old commitment to fund two-thirds of school costs.

These two issues, the TABOR initiative and the Governor's Education Task Force, are tightly connected in the intense politics of taxes that dominate Wisconsin politics. They are connected through the property tax, which is both the most disliked tax of all and also a large component in funding for public education. Public education is the costliest item for state and local governments.

The events of June took place after the body of this paper was delivered (in slightly different form) in April 2004, as part of a colloquium on state tax policy sponsored by the Marquette University Law School. That presentation made two main points. The first was that there is no property tax crisis, no soaring or out-of-control property tax growth that would justify such an extreme measure as a constitutional restriction on government revenue.

The second point of the presentation was the possibility of capitalizing on the dual role of the property tax mentioned above, by combining cuts in the property tax with increases in education funding. The suggested mechanism was a two-penny increase in the state sales tax (an increase from 5% to 7%, yielding approximately \$1.6 billion annually), using one penny of the new sales tax revenue for property tax reduction and the other penny for increased school revenue. This proposal turned out to foreshadow the tax recommendation of the Task Force. The Task Force proposal uses a similar amount of sales tax revenue but moves it entirely into property tax reduction rather than using half of it for schools, a significant difference. The Task Force separately recommended over \$200 million in additional school revenue from the state, without suggesting a revenue source for most of it.

If this indeed is a turning point in the politics of taxes, it is because there is growing recognition of the importance of preserving high-quality public services. Across the country, the antitax fervor is often the surface manifestation of more disguised attacks on public education and all institutions of government. The alternative is a more traditional approach to government in Wisconsin: One that believes that public services must be maintained at a high level, and that we must adjust taxes accordingly.

II. SOME SOURCES OF RESENTMENT AGAINST THE PROPERTY TAX

There clearly is a tax revolt of some kind going on in Wisconsin. For many politicians who find this fertile territory, there is a focus on the property tax as the source of most taxpayer distress. Republican State Senator Mary Panzer, the Majority Leader, expressed it clearly when she said that “property taxes have strained the ability of Wisconsin residents to pay” and she warned of “an emerging taxpayer revolt.”¹ The *Milwaukee Journal Sentinel* further quoted Panzer saying: “The footsteps of taxpayers are what we’re hearing. The footsteps are getting louder and louder and louder. They simply have reached their capacity to pay the taxes.”²

But are property taxes at a crisis level? Is this a crisis that only something like TABOR, a constitutional restriction on revenue growth, can solve? We will examine the underlying economics of property taxes to understand if there is a crisis and whether the situation is one deserving of a constitutional remedy.

Wisconsin policymakers still await a new, comprehensive tax-incidence study of how the property tax affects different categories of taxpayers in the current state economy. Such a study is expected soon from the Wisconsin Department of Revenue. Until then, a good source is the 2003 tax-incidence study from the Institute for Taxation and Economic Policy (“ITEP”), a nonpartisan, nonprofit tax research organization based in Washington, D.C. According to its study, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*,³ while Wisconsin’s sales tax affects lower income households the most and the income tax touches upper income people the most, the property tax digs more at families in the middle.

The sales tax is significantly regressive, with households in lower income ranges paying a larger proportion of their income in sales tax than households in higher income ranges. As Figure 1 reflects, households in the bottom 20% among nonelderly taxpayers (incomes below \$18,000) paid 6.7% of income in sales taxes in 2002. Those in the top 1% (incomes above \$263,000) paid only 1.2% of income in sales taxes. This is a classic example of a regressive tax, a common feature of sales taxes even with Wisconsin’s exemptions on sales taxes for groceries, health care, and almost all services.

1. Steven Walters & Dennis Chaptman, *Senate Falls One Vote Short on Veto Override*, MILW. J. SENTINEL, Aug. 13, 2003, at <http://www.jsonline.com/news/state/aug03/161869.asp>.

2. *Id.*

3. For the Institute on Taxation and Economic Policy, see <http://www.ctj.org/itep/index.htm>. For the full report, see <http://www.itepnet.org/whopays.htm>. For Wisconsin-specific results, see <http://www.itepnet.org/wp2000/wi%20pr.pdf>. Data in figures 1–3, *infra*, are drawn from this report.

Figure 1 - Sales tax hits lower income households

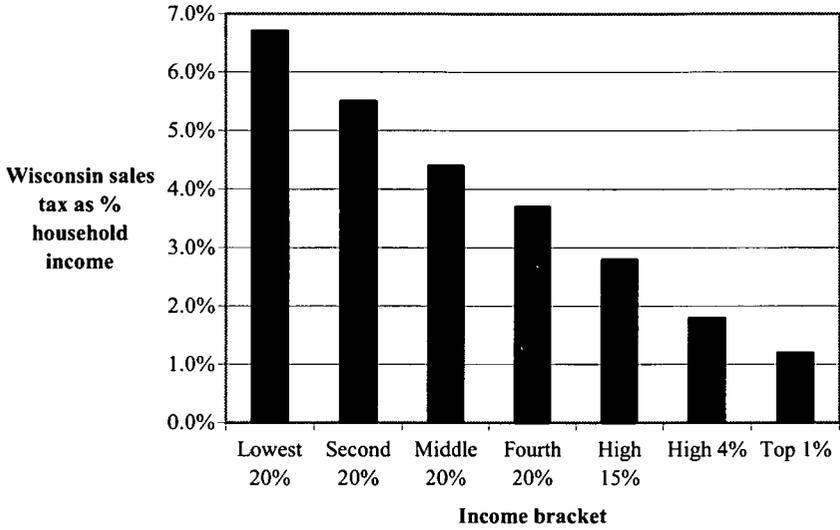
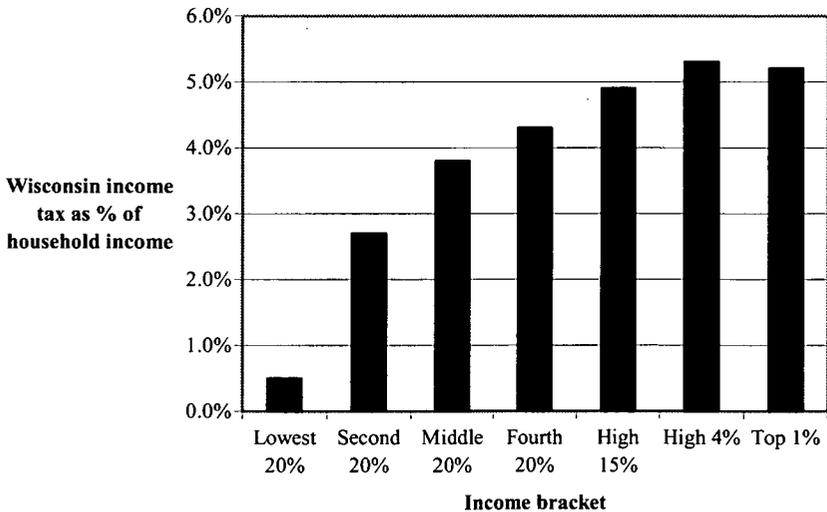


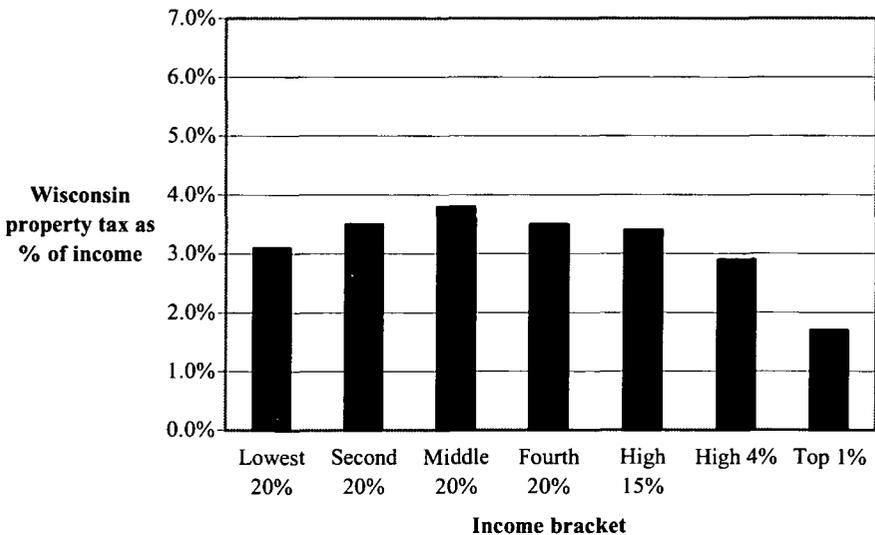
Figure 2 - Income tax hits upper incomes



The state income tax, by contrast, is moderately progressive, with low-income households paying a smaller percentage of their income than those with high incomes. [See Figure 2.] For example, households in the lowest income quintile paid only 0.5% of income as personal income tax, compared with 5.0% for those in the highest 1%. The income tax is only moderately progressive because the highest marginal tax rate sets in at middle incomes, so those with the highest incomes do not pay significantly higher overall rates than those with middle incomes.

The property tax, on the other hand, is neither regressive nor progressive, but displays a bowed shape with taxpayers in middle-income groups paying the highest percentage of their income. [See Figure 3.] For example, taxpayers in the middle quintile (incomes between \$30,000 and \$48,000) paid 3.8% of their income for property taxes, the highest share among all income groups. The second- and fourth-highest quintiles incurred the second-largest burden, with the poorest and richest taxpayers paying the smallest shares of their income.

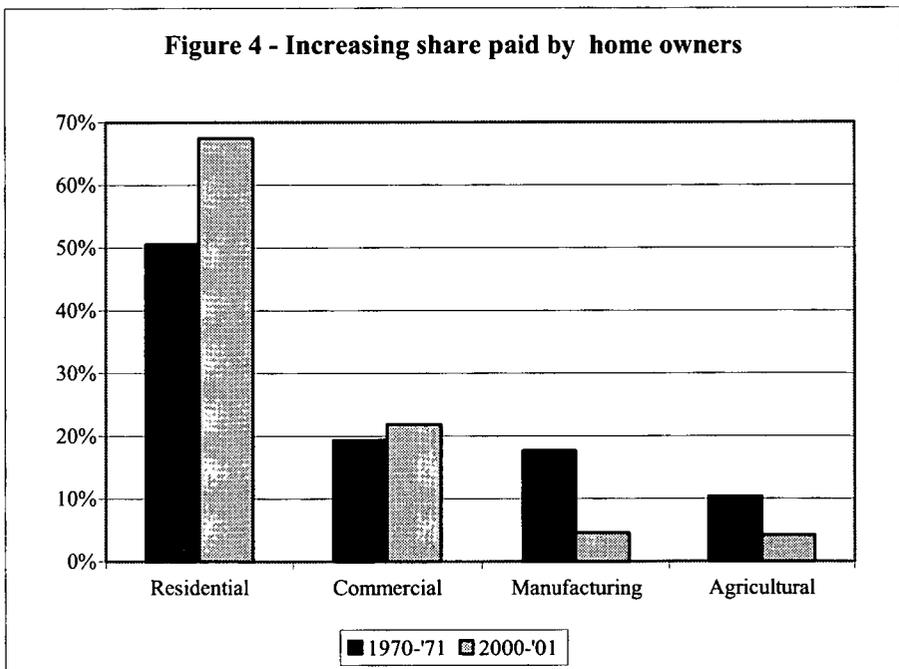
Figure 3 - Property tax hits at the middle



The point is that middle-income taxpayers fare relatively worse on the property tax than with either the sales tax (which hits poorest households the

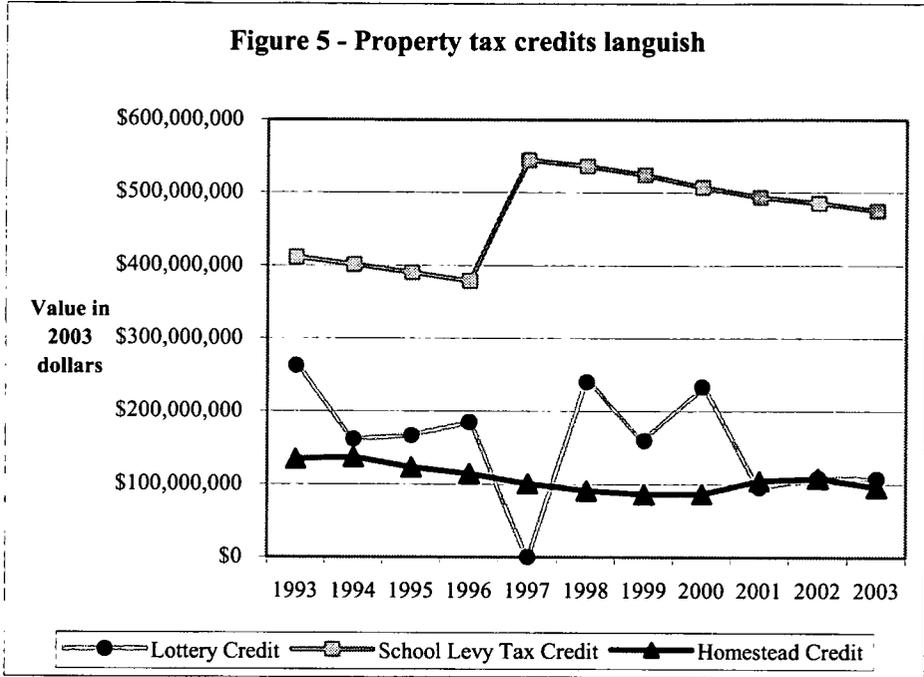
hardest) or income tax (which hits richest households the hardest). From this perspective, there may be at least some basis for a particular sensitivity on the part of middle-class taxpayers to the property tax.

A second factor may help explain a heightened concern by middle-class taxpayers about the property tax. Since the 1960s, a significant portion of property taxes has been shifted from manufacturing and agricultural property owners to residential owners. [See Figure 4.] For example, in 1970 residential homeowners paid 50.6% of all Wisconsin property taxes, but by 2000 that had grown to 67.5%.⁴ The share paid by owners of manufacturing and agricultural properties fell substantially during the same period (manufacturing from 17.7% to 4.6% and agricultural from 10.4% to 4.2%) because of new large tax exemptions for manufacturing property and a switch in the method of calculating the value of agricultural property. The result is a second factor helping to explain some middle-class resentment against the property tax.



4. Rick Olin, *Informational Paper 13: Property Tax Level in Wisconsin*, WIS. LEGIS. FISCAL BUREAU (Jan. 2003), at <http://www.legis.state.wi.us/lfb/Informationalpapers/13.pdf>.

A third reason for displeasure with property taxes is that while Wisconsin uses three different property tax credits, intended to reduce the impact of property taxes, all three have languished in real value because of the effect of inflation on a credit that has been constant in (nominal) dollars. [See Figure 5.]



The School Levy Tax Credit has been a fixed nominal amount since 1997 (\$469.3 million) and is therefore dwindling in real (inflation-adjusted) value. The Lottery Credit has been up and down in nominal terms, but the long-term trend is down, dropping from over \$200 million to about half that. The Homestead Credit has also dwindled as a result of inflation eating into a generally stable amount in nominal terms. So a third reason why there is middle-class resentment against the property tax is that the three methods used in Wisconsin for property tax relief have all been declining, when measured in inflation-adjusted dollars.

Finally, another source of resentment is that the property tax does not distinguish among varying levels of ability to pay. For example, it is well known that some older homeowners have relatively low incomes but may still have relatively high property tax bills, because of the appreciation of the value of their homes even while they have shifted to retirement income. There is a particular problem of this sort in the case of school property taxes because of

the equalization structure in the school aid system, which produces less state aid to school districts with higher property wealth (as measured on a per student basis).

There are a number of rural school districts in Wisconsin, especially across the northern part of the state, with relatively high property values but relatively low incomes. These are school districts that include recreational lakes, where property values have increased significantly because of buying pressure for resorts and summer homes. For year-round residents, however, incomes are relatively low. For example, in a group of 48 school districts spanning northern Wisconsin—from Wausaukee in the northeast to Saint Croix Falls in the northwest—the median property value per student was \$523,759 (in the 2000 US census), far above the \$295,819 for the rest of the state.⁵ On the other hand, the median household income in this northern lake belt was \$33,391, far below the \$53,921 for the state's suburban districts, \$41,892 for urban districts, and \$39,971 for other rural districts.⁶ There are other such clusters (such as Door County and the lake and river areas in south-central Wisconsin), with relatively high property values because of vacation property, but relatively low incomes for year-round residents whose children go to public school.

In these cases, the school aid system provides relatively little state aid to these income-poor districts, because of the high property value. The school aid system treats high-poverty, high-property-value rural districts exactly the same as it treats the high-income, high-property-value suburbs of Milwaukee and Madison. The property tax relief system implemented for school aid is unable to distinguish between two very different kinds of property-wealthy districts.

III. PROPERTY TAXES ARE NOT RISING OUT OF CONTROL

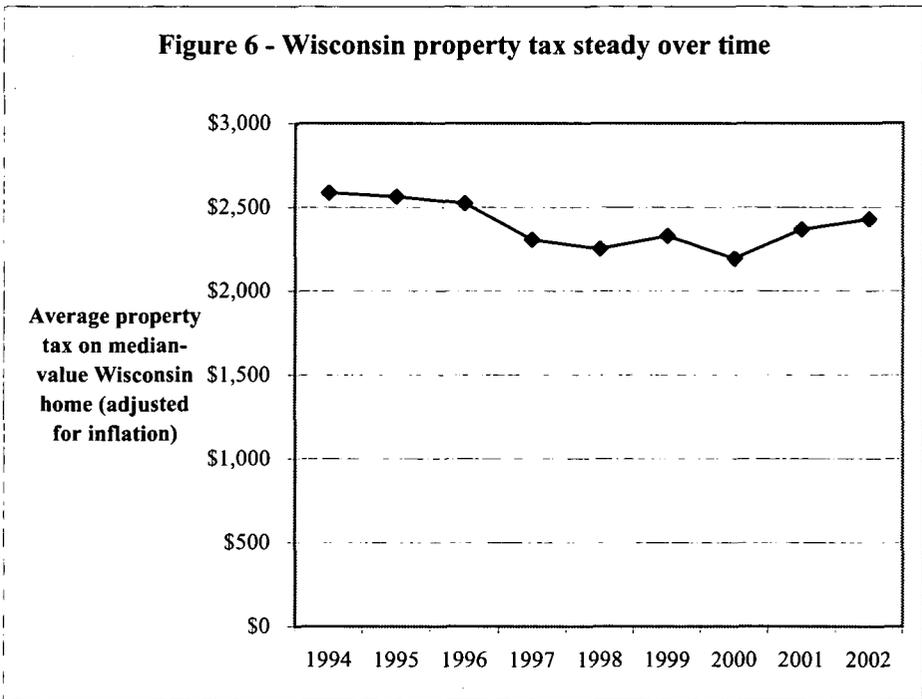
In general, then, there is some basis for middle class resentment against the property tax. There are reasons why property tax reform may be appropriate. But there is nothing approaching a crisis so severe as to demand constitutional redress, in the form of a TABOR-like amendment to restrict the growth of local property tax revenue. In fact, the amount Wisconsin property owners are paying in property taxes is not growing over time (in inflation-adjusted dollars), nor is it taking a growing share of our household income.

The typical level of property taxes paid by a Wisconsin homeowner,

5. Jack Norman, *Wisconsin Atlas of School Finance: Geographic, Demographic, and Fiscal Factors Affecting School Districts Across the State*, Institute for Wisconsin's Future (Feb. 2004), at <http://www.wisconsinsfuture.org/reports/Atlas.pdf>.

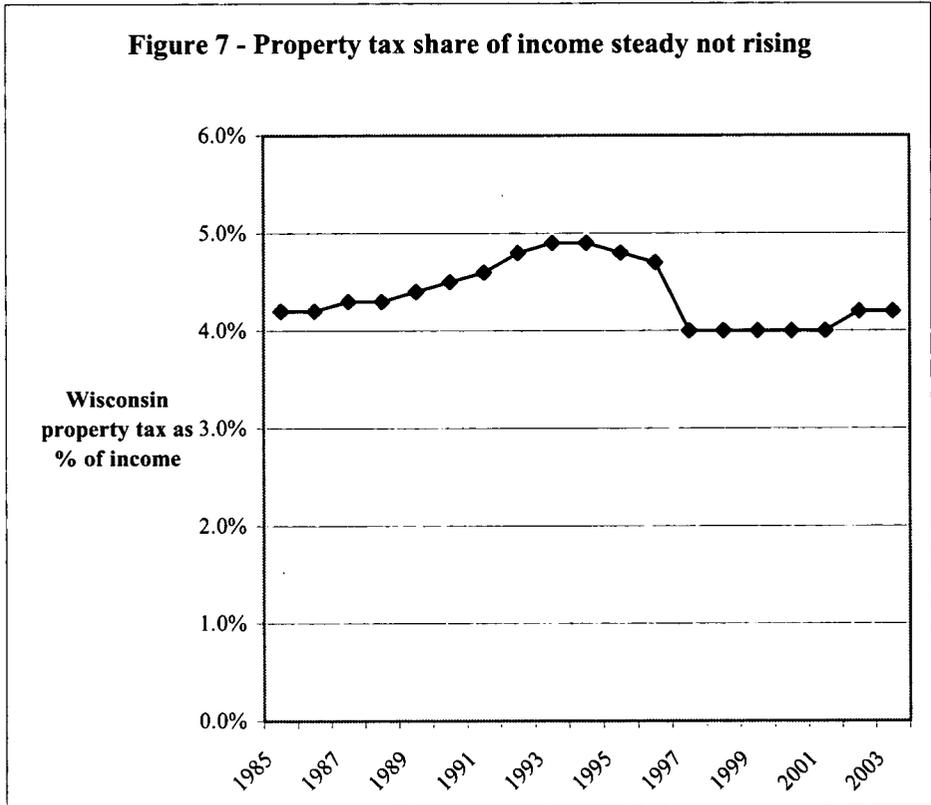
6. *Id.*

measured in inflation-adjusted real dollars, has held relatively constant in recent years. [See Figure 6.] The figure shows the total property tax paid on a home valued at the state median, with state average property tax rates. The median value for a Wisconsin house rose from \$76,226 in 1994 to \$119,370 in 2002, according to the Legislative Fiscal Bureau.⁷ The average net property tax on the median house went from \$2162 to \$2428 during that period, which when adjusted for inflation is actually a decline in real terms. In real (inflation-adjusted) terms, typical home owners in Wisconsin are simply not paying higher property taxes than they were a decade ago.



7. No comparable data are available past 2002.

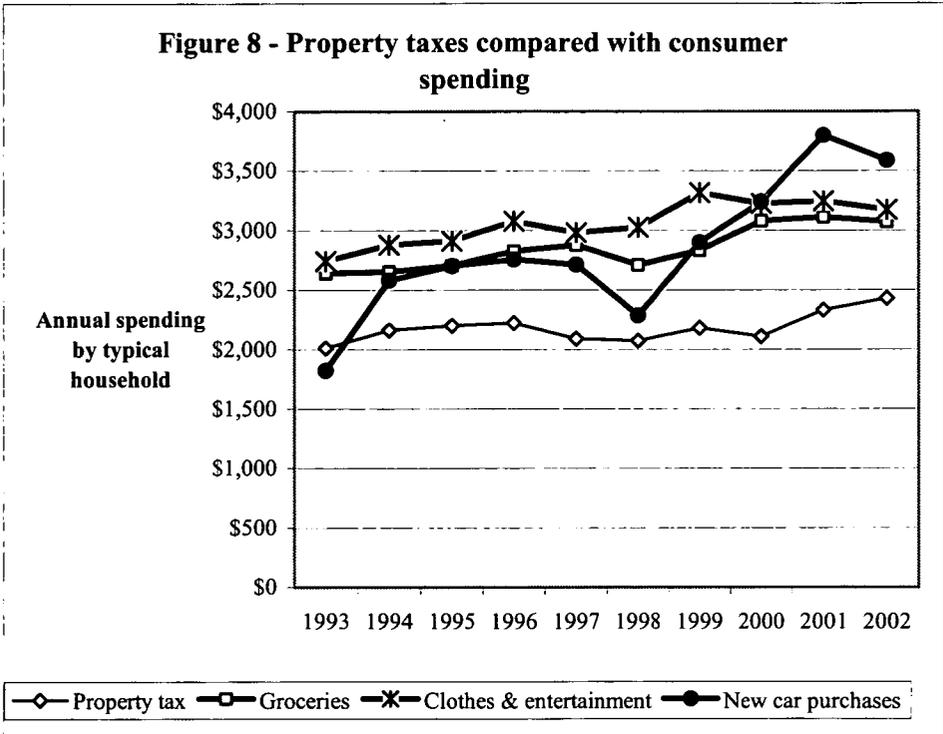
An alternate way of measuring property tax levels is to see what percentage of income goes for the tax. When the typical property tax (as measured above) is taken as a percent of median household value, there has been no increase over time and clearly no surge of a kind that might provoke such a major response as a constitutional amendment. [See Figure 7.] A rise in the early 1990s was offset when the state assumed a greater role of school funding.



Property taxes in Wisconsin have not grown over time. They have not grown as a percentage of incomes. There is no underlying crisis in Wisconsin property taxes. The TABOR constitutional remedy is a solution for a nonexistent problem. The point is strengthened by looking at how spending on property taxes compares with spending on other items of similar magnitudes in the middle-class family budgets.

Figure 8 shows spending on property taxes on the typical Wisconsin home compared with spending by the typical U.S. household on new automobiles,

on clothes and entertainment, and on groceries. None of the figures are adjusted for inflation. Consumer spending data are from the Consumer Expenditure Survey of the U.S. Bureau of Labor Statistics and are for households in the middle quintile of national household income—that is, typical families.⁸



It is clear from the figures that the growth of property taxes for the typical Wisconsin family is not out of control compared with the typical family's spending on such commonplace basics as a car, clothes, entertainment, and groceries. If we need a Taxpayers' Bill of Rights, do not we just as much need a Carbuyers' Bill of Rights? Or a return to a form of Prohibition, a constitutional ban on frivolous spending on glitzy food and entertainment? Or, for some real belt-tightening, a Grocery Bill of Rights to limit increases in spending on food, which track closely spending on property taxes?

TABOR is overkill. There is no underlying crisis in Wisconsin property

8. See U.S. BUREAU OF LABOR STATISTICS, CONSUMER EXPENDITURE SURVEY, at <http://www.bls.gov/cex/home.htm>.

taxes. TABOR is not designed to solve the crisis, because there is not one. The goal of TABOR is not to ease a property tax crisis or any other form of tax crisis. The purpose of TABOR is to dramatically reduce the scope of government.

IV. MEANINGFUL PROPERTY TAX REFORM

Even in the absence of a property tax crisis, however, there are problems with property taxes and there is some underlying basis for middle-class resentment. For many people it is a favorite tax to hate. It is unpopular among those with fixed incomes but rising property taxes. The property tax bill usually arrives just before the December holidays. For many people, it must be paid all at once, without the ease of regular withholding, as occurs with income taxes and without the emotional satisfaction of being accompanied with some perceived good (a pay check or a profit in the case of income tax; a purchase of a new item in the case of sales tax).

In Wisconsin, as elsewhere in the U.S., the largest share of property taxes goes to support public education. About 44% of the total Wisconsin property tax is for the K-12 public school system. Given the importance of the school tax in overall property taxes, and independent calls for reform of the school finance system (such as the political environment that led to Governor James Doyle appointing a special task force to consider school finance), this suggests an opportunity to combine two independently challenging projects: property tax reform and school finance reform. The most efficient way to make progress in both areas may be to combine them into a single reform project.

A concrete proposal to do this is the school finance reform plan advocated by the Wisconsin Alliance for Excellent Schools ("WAES").⁹ That proposal involves major changes in the school finance mechanism, the details of which are not relevant here. What is relevant is the general approach to property taxes.

The WAES proposal is to increase the state sales tax by two cents (or find an alternate source of revenue for the state that yields the same amount, over \$1.6 billion annually). Half the new sales tax revenue would go to reduce school property taxes, and the other half would go to increase school revenue. It is possible to engage in property tax relief without going so far as to impose severe and destructive restrictions on the ability of state and local government to raise funds.

9. See generally, <http://www.excellentschools.org>. The plan details are at <http://www.excellent-schools.org/pdf/WAESPlanMay04.pdf>.