

Comments on the Middle Class STAR Rebate Program, December 5, 2007
To the Assembly Standing Committee on Real Property Taxation
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As the property tax now exists, it violates

the principle of **neutrality**, because it influences and alters decisions from what would occur in its absence;

the principle of **efficiency**, to the extent that it, as well as other taxes, reduces market performance and economies by the "deadweight loss" it generates;

the principles of horizontal and vertical **equity**: those in similar circumstances don't typically bear comparable obligations, nor are those in different circumstances treated in a uniformly commensurate way;

the principle of **administrability**, insofar as its management is likely to be quickly skewed by external forces, and because maintaining adequate and reliable records is so costly;

the principle of **simplicity**, which leads to misunderstanding and opaque application, with the consequent loss of its legitimacy; and

the principle of **stability**, which requires it to be continually jiggered and otherwise modified to provide adequate revenue on which governments depend.

Inherent in these downside effects is the distortion of locational decisions so that land use configurations do not unfold in an optimal ways and lead those who must make such choices to second best alternatives.

What happens to property values over time?

1. The land value tends to increase, sometimes at multiple times the rate of inflation, while the improvement value decreases, a 2000 FRB study says about 1.5% annually.
2. The property values do not change uniformly, even in a single locality, and certainly not throughout the state.

What happens to the assessments?

1. Assessments quickly become inaccurate, even after one or two years' lapse. They no longer accurately reflect the values of property parcels throughout the locality, and the state. Maryland reassesses every parcel in the state every three years.

2. Residential parcels change hands more often than non-residential parcels, which means that the inaccuracies in assessment are quickly skewed to favor non-residential holdings.
3. The costs of a comprehensive revaluation make municipal leaders reluctant to take on the challenge. I addressed this in my prepared testimony in February, 2007.

What happens to formulas intended to relieve identified burdens?

1. Thresholds, floors and ceilings, quickly become obsolete.
2. What is adequate in one region is either onerous or too generous in other regions.

What relief measures are available, and how do they compare?

1. NCSL identifies four that are extensively employed in various states:
 - Caps on assessments and on tax rates
 - Homestead differentials and exemptions
 - Circuit-breaker Provisions
 - Tax Deferral Options, with Interest
2. Only the Deferral option avoids the liabilities listed above.
 - It protects the budget of the locality and taxing system, and is administratively costless.
 - It is fair to everyone, even to those who are not homeowners.
 - It imposes no distortions on individual choice, on the economy or on land use choices.
 - The initiative rests with the titleholder of the parcel.
 - Its terms can be flexible and accommodate to changing circumstances.
 - It is simple to understand and to administer.
 - It can be employed even if assessments are inaccurate or unreliable.
 - It can be implemented immediately, simply by enactment of permissive legislation.

Where are the present problems?

1. Lack of understanding of the nature of the real property tax.
 - that it is really two taxes that have very different economic dynamics -- land and improvements
 - that the tax on land value is really a tax on the flow of economic rent -- not a tax on a "thing."
 - that the market value of location sites is due to the community's enterprise, not titleholders
 - that the tax on improvements is destructive, whereas the tax on land rent is constructive
 - that land value is easily assessed, and cheap to do; improvements are difficult to assess
 - that the tax on land value has a venerable moral philosophy behind it, easily explained
 - that the tax on land value comports with all the textbook principles of sound tax theory
2. Administrative problems with assessment, administrative management, and public understanding
 - Assessments quickly become obsolete
 - The tax regime is quickly distorted and resented
 - Other tax regimes suffer from far greater liabilities