



# Two Steps to Long-Lasting Property Tax Relief:

The Imperative to Constitutionally Dedicate Surpluses and to  
Enact Property Tax Reforms

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# Long-Lasting Property Tax Relief

## Introduction

The property tax is an inequitable, economically-damaging, administratively-costly tax that will continually put the State on a collision course with the constitutional prohibition against a statewide property tax. It must be abolished to end the political and fiscal expense of dragging the public school system through the court, and to end the unjust and excessive taxation of property owners.

With today's announcement by the Office of the Comptroller that the surplus exceeds \$8 billion, dedicating it, along with other tax and budgetary reforms, will set the state on a path to eliminate the school district maintenance & operations (M&O) property tax. In addition to applying the surplus to tax reduction, it is imperative to institute two reforms to protect taxpayers against rapid increases in property taxes even after the current legislature completes its work:

1. Constitutionally dedicate future surplus revenue to property tax elimination. Two years ago, Governor Perry and legislators prudently advocated this approach. Today, the Texas Tax Reform Commission is also calling for at least a partial use of surplus revenue for property tax reduction. By dedicating the surplus, the Legislature can guarantee that property taxes will not adversely impact the economy and will meet the requirements demanded by the Texas Supreme Court.
2. Adopt one or more reforms to restrict and refine the property tax system. Those reforms could include:
  - a. Lowering the current appraisal cap;
  - b. Imposing a revenue cap; and/or
  - c. Eliminating rendering of personal property to stop the growth in the audit powers of local government into business.

This approach will help to lock-in property tax reductions and allow dedicated revenue to buy-down inevitable increases in appraisals and rates by political subdivisions.

## Dedication must be an "Iron-Clad Guarantee"

Revenue and surplus dedication must be written into the constitution and narrowly worded to ensure that money will not be shifted from property tax reduction to new spending programs as has been the history of budget surpluses.

Constitutional dedication of surpluses (or new tax revenues) to property tax buy-down is imperative since previous property tax relief efforts have proven fleeting. For example, the 75<sup>th</sup> Legislature's increase in the homestead exemption from \$5,000 to \$15,000 was a palliative but not a solution: the upward trend in M&O property tax rates was unabated even in the immediate aftermath of passage of HJR 4 (75R).

<u>Year</u>	<u>Statewide Average M&amp;O Rate<sup>1</sup></u>
1996	\$1.24
1997	\$1.26
1998	\$1.30
1999	\$1.36
2000	\$1.38
2001	\$1.39
2002	\$1.43
2003	\$1.45
2004	\$1.45
2005	\$1.46

Taking note of the rapid increase, Governor Perry, in testimony before the Senate Select Committee on April 19, 2004, commented that “[h]istory tells us that property tax cuts passed from Austin do not last very long, and in some cases never make it to Texans’ mailboxes...” The Governor’s 2004 plan called for dedicating one-third of surplus revenue (“new money”) to property tax reduction. SJR 1 (78S4) and HJR 1 (78S4) mirrored the Governor’s recommendation.

As the Governor pointed out in testimony before the House Select Committee on Public School Finance on April 20, 2004, his plan:

“...requires additional property tax cuts during times of surplus until those rates are cut in half, and that would not just be a wink and a nod... it would be an iron-clad guarantee in the Texas Constitution<sup>2</sup>.”

Constitutional dedication of surpluses (or new tax revenues) to property tax relief will ensure that taxpayers actually see their property tax bills shrink, not grow, in future years. However, experience with other constitutionally-dedicated funds shows that unless the text of the amendment is narrowly drawn, the funds are still at risk of being shifted to other programs.

The Economic Stabilization Fund (commonly known as the “Rainy Day” Fund) is limited in the Texas Constitution to appropriations to directly address budget shortfalls. The Constitution, however, provides an easy out for legislators: if two-thirds of each house agrees, the Legislature may appropriate monies from the Rainy Day Fund “at any time and for any purpose.”<sup>3</sup>

Legislators took advantage of that clause in 2003 by creating the Texas Enterprise Fund<sup>4</sup>. The one-time appropriation of \$285 million was spent to lure businesses to relocate to the state. The Enterprise Fund is a very successful tool for economic development. However, the “out clause” buried deep in the language of the Amendment rubs against the purpose of the Rainy Day Fund. The experience with the Rainy Day Fund proves that the dedication in the Texas Constitution must be clear and unambiguous without an escape clause that allows legislators to use those revenues for anything other than property tax reduction.

The State Highway Fund (Fund 6) illustrates another problem with dedicated funds. Revenues generated by motor vehicle registration fees, and from motor fuels and lubricants taxes, are constitutionally dedicated to<sup>5</sup>:

- Acquiring rights-of-way;
- Constructing, maintaining, and policing such public roadways;
- Administration of traffic and safety on such roads, and;
- Payment of principle and interest on certain county and road district bonds.

However, this is misleading. Over \$737 million in revenue is credited to the Fund<sup>6</sup> though not protected. As a consequence, the 79<sup>th</sup> Legislature appropriated money in Fund 6 to programs that are not directly related to road-building, a critical need in Texas. Some of the appropriations from the State Highway Fund, include:<sup>7</sup>

- \$42 million dollars to the Department of Transportation to finance a ferry system;
- \$20 million to be spent on the Children and Medically Needy programs under the Health and Human Services Commission; and,
- \$85 million on salary increases for state employees.

While the ferry system appropriation is at least transportation related, it amounts to a \$42 million reduction in revenue from the stated purpose of the Fund: new highway construction, acquisition of rights-of-way, or debt payments.

The other examples of misappropriated Fund 6 monies are egregious: government-run health programs and higher state employee salaries are not new highway construction.

By making these appropriations from the State Highway Fund, legislators, while not circumventing the constitutionally dedicated portion of the Fund, have certainly violated its spirit to the detriment of transportation projects.

Since the Texas Supreme Court has ruled the system of school finance unconstitutional because rising M&O rates have effectively created a statewide property tax, the only fiscally conservative way to get out of court would be to set the state on a path toward the elimination of the tax itself. This can be done by, among other things, dedicating current and future surplus revenue to that end as Governor Perry has argued.

*See the Appendix on Page 7 for model language to constitutionally dedicate surplus revenues to reduction of the M&O rate.*

### **Systemic Property Tax Reforms**

Another step is necessary to ensure that property tax relief is both realized and long-lasting: reforms to the way the property tax is administered.

For example, one existing taxpayer protection, the constitutional appraisal cap<sup>8</sup>, could be lowered. The 10% appraisal cap (first enacted in 1997) prevents the appraised value of a home from increasing by more than 10% in any given year. In theory this protects against appraisal creep, a backdoor method by which property taxes increase.

Tax bills since the enactment of the 10% appraisal cap indicate that, in practice, the cap gives local governments too much room to increase tax bills. Appraisals have increased dramatically across the state, but especially in Harris County where the taxable value of homesteads rose by more than 46% from 1996 to 2001, causing tax bills to increase by nearly 57%<sup>9</sup>. Under the current cap, an increase of 46% in five years is allowed. If the cap is lowered to 5%, however, the maximum five year increase in appraisals would be 25%.

A Comptroller report on property values indicates that the 10% appraisal cap is too high<sup>10</sup>:

For tax year 2004, taxable values increased in 933 school districts, with an average increase in value of more than 7 percent. In comparison, 764 school districts had an average increase in value of more than 8 percent in tax year 2002.

The final 2004 study, before exemptions, revealed an increase of more than 7 percent in the value of single-family residences...

Comparing appraisal increases to percent changes in inflation and median home prices shows how political subdivisions game the system to their benefit:

**Percent Increases in:**

	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>Inflation</b> <sup>11</sup>	3.4%	2.2%	0.9%	2.1%	2.4%	3.8%
<b>Median Home Price</b> <sup>12</sup>	11.1%	6.5%	4.3%	2.7%	1.7%	4.8%

The fact that increases in government appraisals can greatly outpace inflation and home prices emphasizes the need for a lower appraisal cap. With an appraisal cap as low as 5%, local property tax bases could still keep up with both inflation and increases in the housing market. With the existing 10% appraisal cap in place, growth in property taxes, both in rate and appraisals, well outpaces economic growth.

In 2004 and 2005, Governor Perry argued for a lower appraisal cap to protect property owners from unjust property valuation increases. The Governor’s plan in the spring of 2004 included lowering the existing 10% appraisal cap to 3%.

In the 79<sup>th</sup> Legislature, Representative Dwayne Bohac, sponsor of HJR 35 (79R)<sup>13</sup>, made a critical point:

“In 1997, the legislature passed appraisal protection in order for homeowners to actually enjoy the relief. The same is true of the property tax relief we are trying to pass today. If we simply lower school property tax rates but do not lower the

appraisal cap, any tax cut we give homeowners will be eaten up by appraisal creep.”

As Governor Perry and many other legislators have repeatedly argued, lowering the property tax rate (by whatever mechanism) must be coupled with property tax reforms to ensure relief is realized and long-lasting. Other property tax reforms previously considered by the Legislature include:

- Lowering the existing rollback rate from 108% to 103%, giving voters the opportunity to approve or reject smaller increases in their property tax rate<sup>14</sup>.
- Requiring a majority of directors of an appraisal review board be elected. This would make officials in charge of property taxes be responsive to voters, as opposed to the taxing districts which currently appoint directors<sup>15</sup>.
- Ending the requirement that businesses must render tangible personal property (desks, chairs, computers, etc.) for appraisal for school property taxes<sup>16</sup>. This process is administratively burdensome, unnecessarily increases businesses' tax bills, and is extraordinarily intrusive.
- Ending certain exemptions to the property tax. The Comptroller has identified \$4.7 billion in school property tax exemptions for tax year 2005 alone<sup>17</sup>. Exemptions to the school property tax include: Implements of farming, ranching, and timber; Private schools, and Marine Cargo containers.<sup>18</sup>
- Placing revenue caps on political subdivisions, including school districts, to end their incentive to increase property tax rates and appraisals.

Some or all of these reforms must be enacted to ensure that a cut in the M&O rate is not consumed by local increases in both rates and appraisals.

### **Conclusion**

By specifically and narrowly dedicating funds to property tax reduction in the Texas Constitution and by enacting property tax reforms, legislators can deliver a property tax relief package that is real and long-lasting.

## Appendix:

The TCCRI recommends the following language for constitutional dedication of current and future surpluses for property tax reduction:

(a) In this section:

(1) "Available state revenue" means state revenue from any source other than federal funds. The term does not include revenue that, under another provision of this constitution, may be used only for a particular purpose.

(2) "Surplus revenue" means the amount by which the estimate made by the comptroller of public accounts under Section 49a(a), Article III, of this constitution of available state revenue for the succeeding fiscal biennium exceeds the estimate made by the comptroller under that section of available state revenue for the current fiscal biennium.

(b) In each fiscal biennium, the total amount of surplus revenue must be used to reduce, as provided by general law, the rate of the school district maintenance tax.

(c) This section is intended to specifically preclude any and all expenditures of surplus revenue other than for the purpose expressly stated in (b).

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<sup>1</sup> Compiled from School District Report of Property Value forms (form 50-108), Texas Comptroller of Public Accounts; Note: figures are rounded to the nearest hundredth.

<sup>2</sup> See Section 2 of HJR 1, (78S4), Rep. Kent Grusendorf

<sup>3</sup> Texas Constitution, Article III, Section 49-g (m)

<sup>4</sup> See Section 2 of SB 1771, (78R), Sen. Kim Brimer

<sup>5</sup> Texas Constitution, Article VIII, Section 7-a

<sup>6</sup> 2006-07 Certification Revenue Estimate, Texas Comptroller of Public Accounts, Table A 11, p. 14, <http://www.window.state.tx.us/taxbud/cre0607/alltables.pdf>

<sup>7</sup> State Highway Fund No. 6 expenditures and appropriations, Legislative Budget Board

<sup>8</sup> Texas Constitution, Article VIII, Section 1(i)

<sup>9</sup> *Property Tax Appraisal: Issues and Responses*, House Research Organization Focus Report, p. 1, <http://www.capitol.state.tx.us/hrofr/focus/property.pdf>

<sup>10</sup> Annual Property Tax Report, Tax Year 2004, Texas Comptroller of Public Accounts <http://www.window.state.tx.us/taxinfo/proptax/annual04/focus.html>

<sup>11</sup> Percent change in annual consumer price index (urban wage earners and clerical workers) for the "South urban" area, U.S. Department of Labor, Bureau of Labor Statistics

<sup>12</sup> Texas MLS Residential Housing Activity, Real Estate Center at Texas A&M University <http://recenter.tamu.edu/data/hs/hs800a.htm>

<sup>13</sup> Also, see HB 784, (79R) by Rep. Dwayne Bohac

<sup>14</sup> See HB 1006, (79R), Rep. Carl Isett

<sup>15</sup> See HB 177, (79R), Rep. Anna Mowery

<sup>16</sup> Tax Code, Chapter 22

<sup>17</sup> Texas Comptroller of Public Accounts, "Tax Exemptions and Tax Incidence", January 2005, p. 36 <http://www.window.state.tx.us/taxinfo/incidence05/incidence05.pdf>

<sup>18</sup> *Ibid*, page 39 & 40

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