

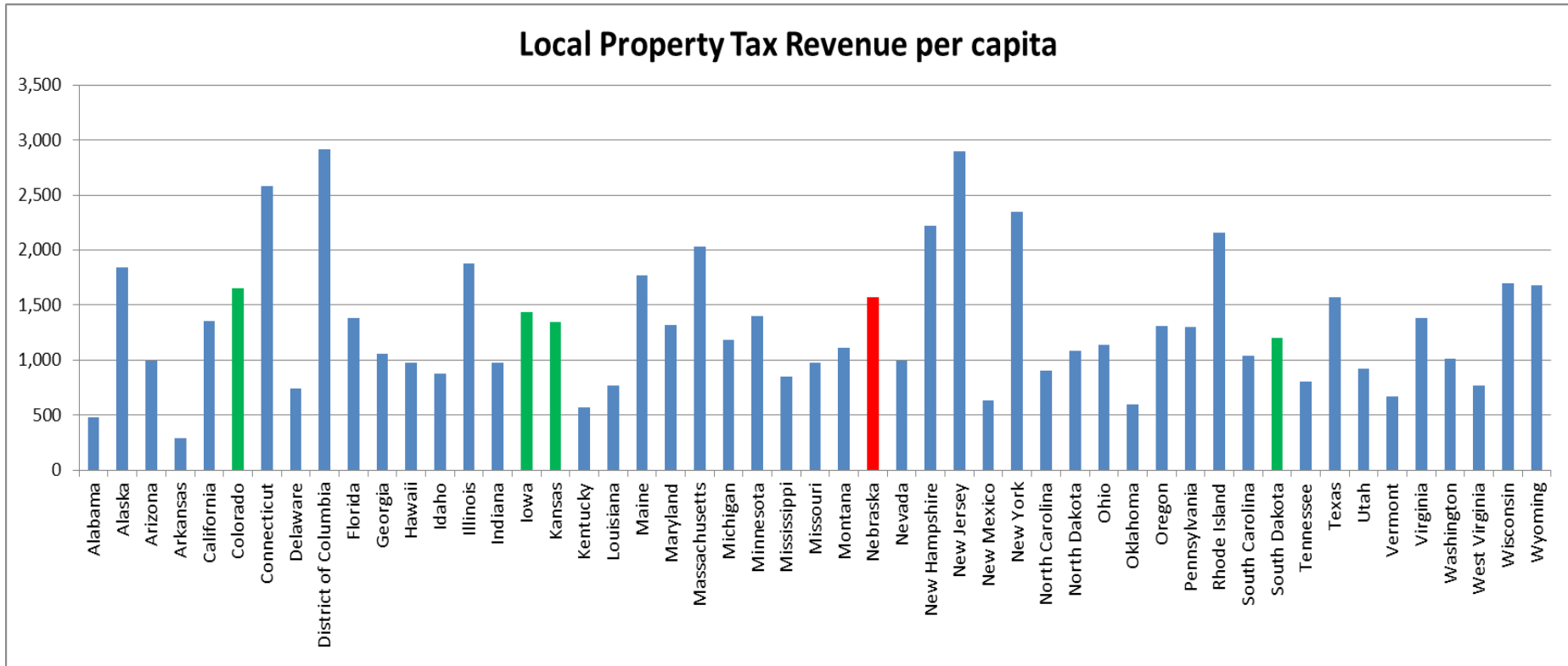
Property Taxes in Nebraska

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Overview of property taxes in Nebraska compared to other states

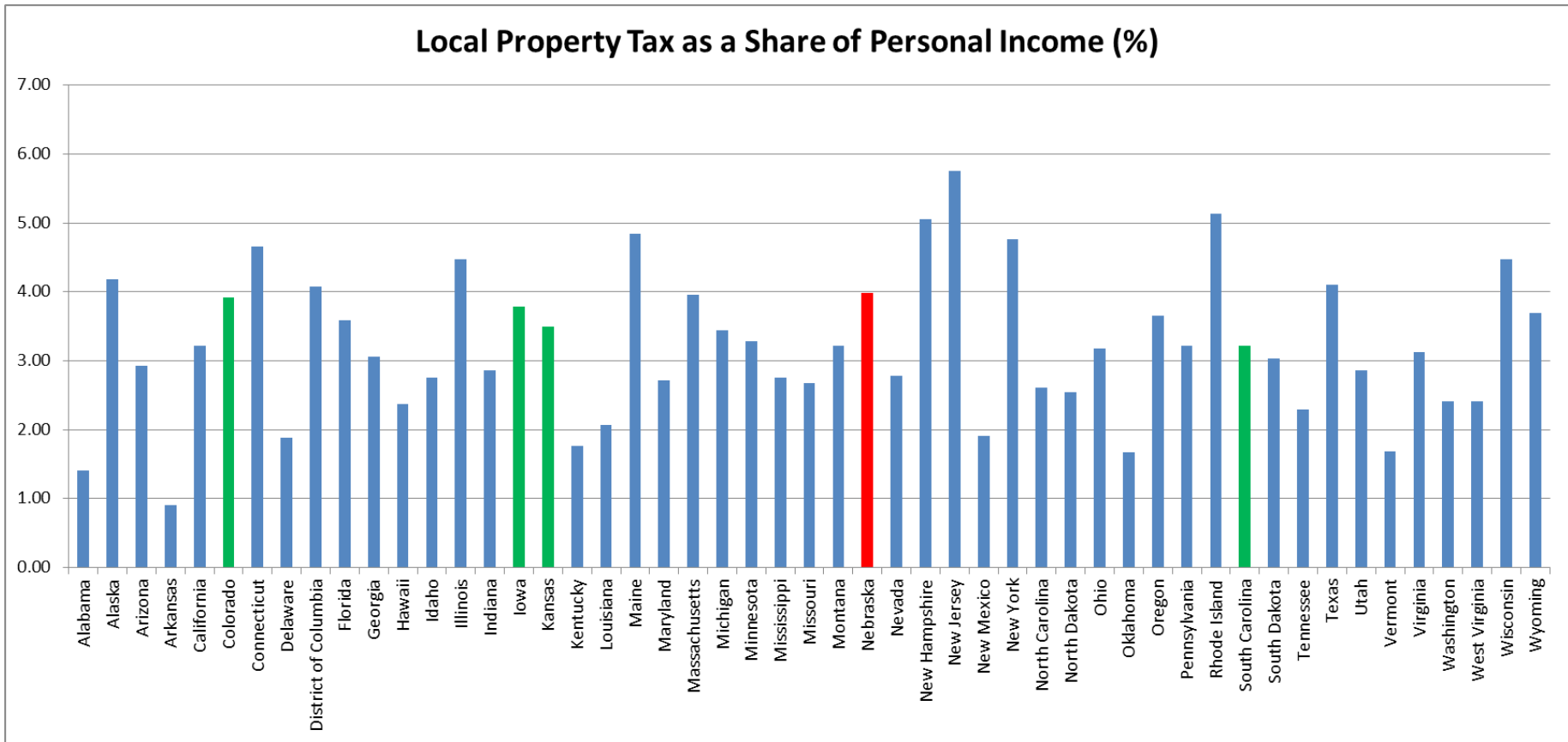
- Consider three ways to view Nebraska property taxes in comparison with those in other states:
 - Property taxes per capita (\$)
 - Property taxes as a share of personal income (%)
 - Property taxes as a share of general revenue (%)
 - State and local property tax as a percent of state and local own-source general revenue
 - Local property tax as a percent of local own-source general revenue

Local Property Taxes per capita, 2011



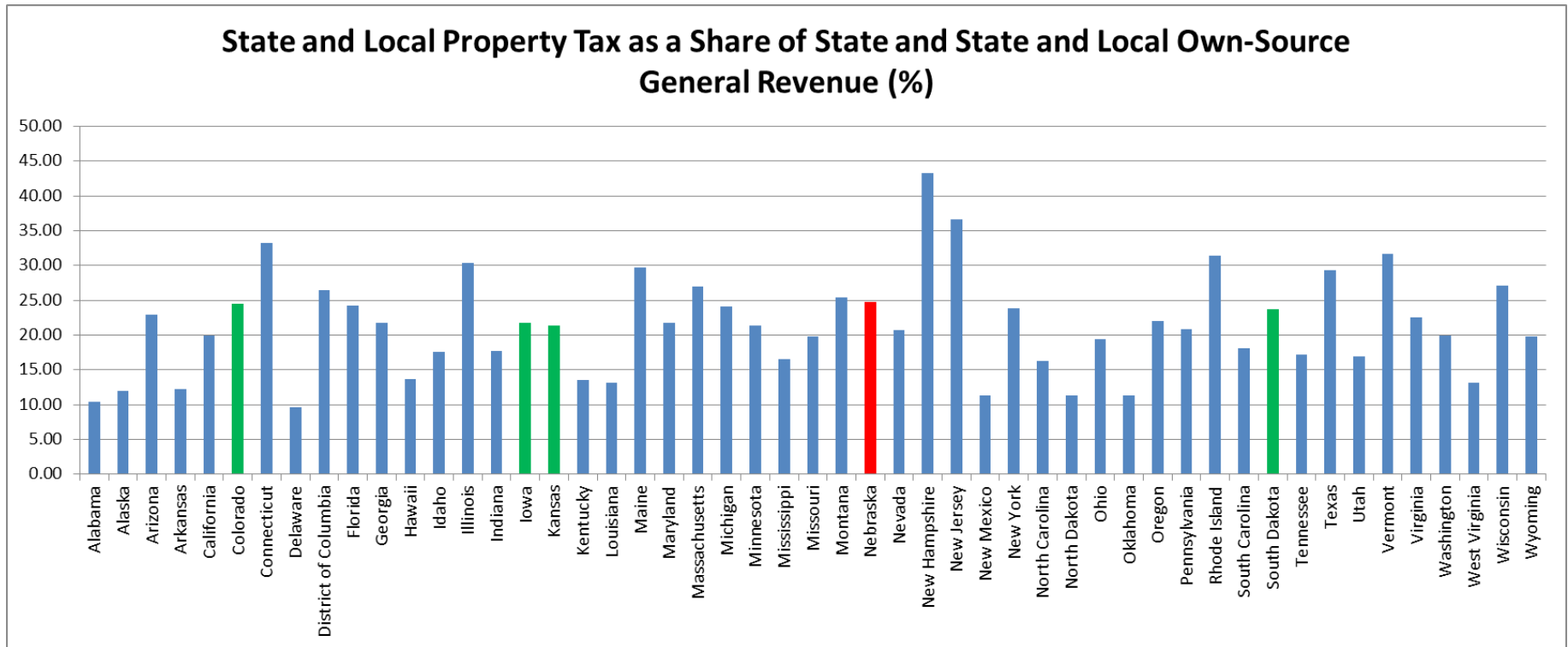
Source: U.S. Census Bureau, 2011.

Local Property Taxes as a Share of Personal Income (%), 2011



Source: U.S. Census Bureau, 2011, and Bureau of Economic Analysis.

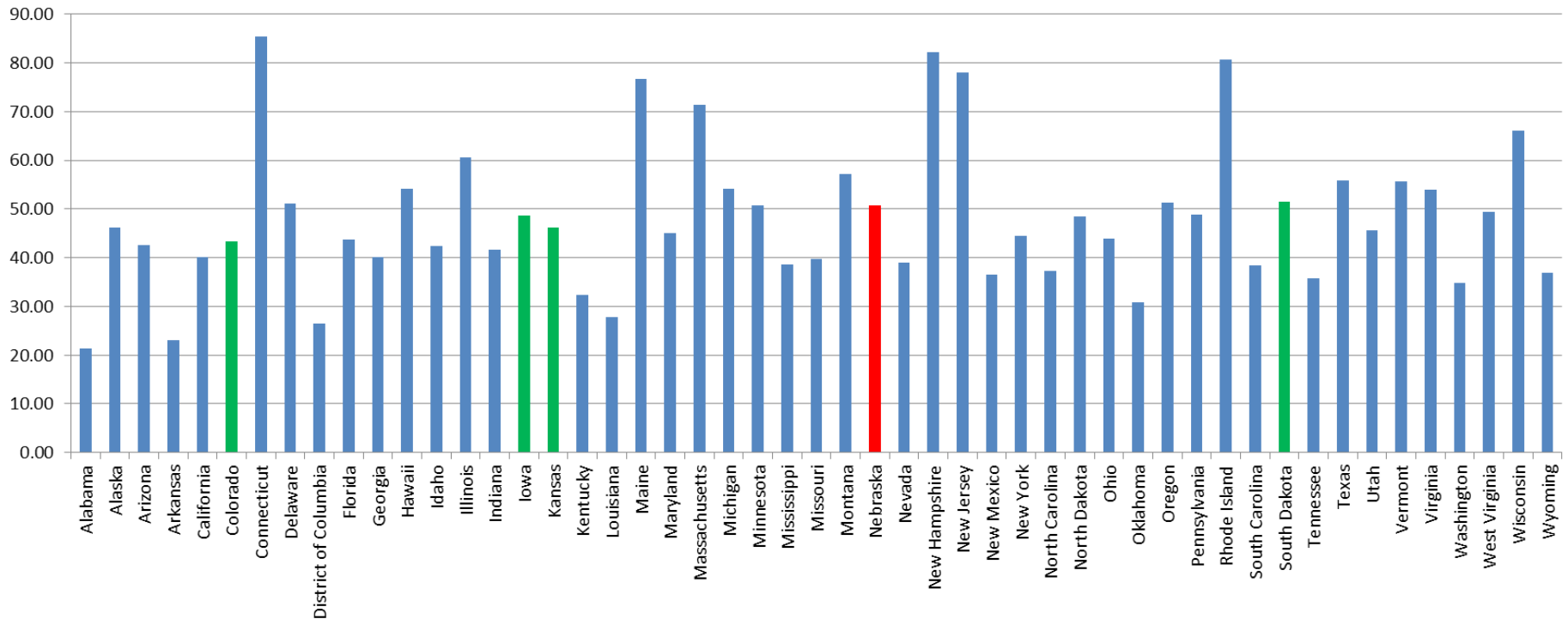
State and Local Property Taxes as a Share of State and Local Own-Source General Revenue (%), 2011



Source: U.S. Census Bureau, 2011.

Local Property Tax as a Share of Local Own-Source General Revenue (%), 2011

Local Property Tax as a Share of Local Own-Source General Revenue (%)



Source: U.S. Census Bureau, 2011.

Role and purpose of the property tax system

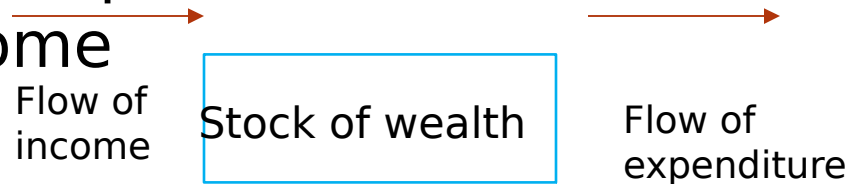
- Primary source of own-source revenue for local government units, especially school districts
- Essential element of a decentralized fiscal system—local government tax base and ability to set tax rate
- Aligns desires of local resident/voters with their willingness to pay for local public goods and services

Design of a property tax system

- Underlying motivation of a property tax system is that the local public services provided to community residents are valuable
 - Residents should pay to support the provision of those public services
 - Property taxes are used because they have both benefit and ability-to-pay aspects:
 - Benefit consideration: Public services provided to residents increase the value of their property; hence they should pay for those benefits in proportion to the value of property owned
 - Ability-to-pay consideration: As a tax on property wealth, the property tax is based on residents' ability-to-pay

Design of a property tax system

- Distinguish between stock and flow measures: property value is a stock concept (stock of wealth) whereas income is a flow concept (flow of income per year)
- Relationship between stock and flow/wealth and income



- Value of an asset is given by the perpetuity formula: where V is the value of a real asset, R is the annual net income or rent generated by the asset, and i is the interest rate used to discount future rent

Design of a property tax system

- A tax can be applied to either the value of the property or the net income generated by the property
- A property tax is applied to value, not income, although the two are related
- An equivalence relationship exists between a tax on annual net rent and a tax on property value :

Ideal tax base is the market value of property

- Market value reflects what a willing buyer pays to a willing seller (arms-length transactions) for property
- Market value reflects “highest and best use” of property
- Alternative measures of property value distort the tax system and may thereby distort land use and the location of mobile capital
 - acquisition value (e.g California)
 - current use-value (e.g. ag value used in most states)

Ideal tax base is the market value of property

- Assessment administration
 - Property tax system requires appropriate assessment of property value on a regular basis
 - Assessment ratio:
 - Equalization process is necessary for equity in the system
 - Interaction with school aid formula (based in part on property value per pupil) is an important issue

Property tax burdens and tax relief

- Nominal and effective tax rates
 - The effective tax rate is the product of the assessment ratio and the nominal tax rate:
 - Effective rate of taxation depends not only on the statutory tax rate (i.e. the nominal rate), but also depends crucially on the assessment ratio
 - So, for example, in Nebraska if the nominal tax rate is two percent, $=.02$, residential property assessed at $=1$ pays an effective tax rate of $=.02$, or 2%, whereas agricultural property assessed at $=.75$ pays an effective tax rate of $=.015$, or 1.5%.

Property tax burdens and tax relief

- Incidence: Who (really) bears the burden?
 - Distinction between statutory incidence (according to the law) and economic incidence (determined by markets) is important
 - Usual suspects: land owners, capital owners, housing consumers, and labor suppliers
- There are three views of the incidence of the property tax:
 - Traditional view
 - Benefit view
 - Capital tax view

Traditional view

- The land tax portion creates a burden that falls on landowners (since land is fixed in supply), and the portion that falls on structures (i.e. capital) is borne by consumers of housing.
- Focus is on what happens when there is a tax increase in a local (isolated) housing market
 - Open economy assumption—return to capital is fixed (i.e. no change)
 - Local capital bears none of the burden of the tax because in the long run it migrates from high tax jurisdictions to low tax jurisdictions eventually equalizing the return at the national rate.

Burden of the tax is therefore borne by local factors (e.g. land) and consumers of housing.

The entire burden is borne by local housing consumers in the form of higher house prices.

The tax reduces the size of the local housing stock and the burden of the tax is borne in proportion to housing consumption; hence the *burden is regressive*.

Benefit view

- This view of the property tax assumes that consumer mobility (voting with their feet) a wide range of community options assures an efficient provision of local public services, with sufficient tax revenue generated to pay for those services.
- Perfect capitalization of services and taxes occurs, converting the property tax into a pure benefit tax (or user charge). Hence, the tax is non-distortionary.
- As a benefit tax, there are *no burden effects of concern*.

Capital tax view

- Under this view the property tax is a general tax on land and capital. Since the property tax is used nationally, the average rate of taxation reduces the return to capital everywhere (profit tax effect).
- It is, therefore, a distortionary tax that reduces the return to land and capital nationally, with no shifting of the tax burden. Because capital income is distributed progressively, the *capital tax burden is progressive*.
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In addition, local deviations around the national average property tax cause further distortions (excise tax effects)

In high tax jurisdictions capital flees, while in low tax jurisdictions it is attracted. As a result, the tax burden is borne by a combination of housing consumers, land owners, and labor suppliers.

Property tax burdens and tax relief

- Relief mechanisms
 - Classified tax system:
 - Nebraska does this with its classification, taxing agricultural property differently from other classes of property ($r = .75$)
 - Homestead exemptions:
 - Nebraska does this with its homestead exemption program for elderly and disabled homeowners
 - Rate caps
 - Nebraska has caps (levy limits, e.g. \$1.05 for school districts)
 - Caps on assessment increases
 - Nebraska does not have caps on assessment increases

Property tax burdens and tax relief

- Use-value assessment of agricultural land in urban areas:
 - In terms of the simple perpetuity formula, an estimate of annual net income in current use is capitalized with a discount rate . A 50-state review indicates that states vary widely in their statutes and regulations on how to measure both and .
 - Nebraska's version: special valuation regulations (Nebraska Administrative Code, Title 350, Chapter 11)
 - Applies to properties in or near urban areas (Greenbelt designation)
 - Research indicates that the difference between market value and current use value diminishes with distance from the urban fringe.
 - A few miles out, there is no effective difference.
 - In predominantly agricultural areas market value *is* current use value.

Property tax burdens and tax relief

- Circuit breakers:
 - A pure circuit breaker is a property tax relief mechanism that is based on the ratio of property taxes paid relative to income
 - Income-based relief: targets tax relief to those most in need (measured by property taxes relative to income)
 - Often designed as an income tax credit (may be fully refundable)
 - Nebraska does not do this, but if it were considered the full set of property tax relief mechanisms should be examined (classified system, homestead exemptions, and ad hoc state relief)