

Horizontal Inequity, Vertical Inequity and the District of Columbia's Property Assessment Limitation

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District of Columbia
Office of the Chief Financial Officer

Conventional Property Tax Relief Programs

- Homestead Exemption/Deduction
- Circuit Breakers
- Deferral Programs
- Tax Freezes
- Income Tax Credits
- Classification
- Nonannual Reassessments
- Tax Rate Reductions

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A Call for a New Type of Relief in 1978

- ❑ In the 1970's, rapid and highly unpredictable annual assessment growth was deemed problematic in California
- ❑ Legislators were not responsive to taxpayers' demand for relief from tax increases caused by rapid assessment growth
- ❑ After several failed attempts, beginning as early as 1968, Proposition 13 passed (65% to 35%) in 1978
- ❑ One of the key features of Proposition 13 was the limitation on annual assessment growth

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Changing the Nature of the Real Property Tax

- ❑ Typically, the property tax is an ad valorem tax
 - Annual tax bill is a function of property value
 - Helps to ensure a more equitable distribution of tax burden
- ❑ Alternatively, a Tax Cap Policy (TCP)
 - Severs the link between a property's market assessment and taxable assessment
 - Limits the annual growth in the taxable assessment

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DC's Property Tax Policy and the Annual Tax Burden of the Median Homestead

	2001	2002	2003	2004	2005	2006	2007
Market Assessment	\$128,499	\$155,227	\$187,514	\$226,517	\$273,632	\$330,548	\$400,050
% chg		20.80%	20.80%	20.80%	20.80%	20.80%	21.00%
Assessment minus Homestead	\$98,499	\$125,227	\$157,514	\$196,517	\$235,632	\$270,548	\$340,050
Capped taxable assessment		\$110,319	\$123,557	\$138,384	\$146,030	\$136,433	\$150,076
Tax bill	\$946	\$1,059	\$1,186	\$1,328	\$1,402	\$1,255	\$1,321
% chg		12.00%	12.00%	12.00%	5.50%	-10.50%	5.20%
Effective tax rate	\$0.74	\$0.68	\$0.63	\$0.59	\$0.51	\$0.38	\$0.33
% chg		-7.30%	-7.30%	-7.30%	-12.60%	-25.90%	-13.10%
Tax relief value	\$288	\$431	\$614	\$846	\$1,225	\$1,864	\$2,400
Relief percentage	23.30%	28.90%	34.10%	38.90%	46.60%	58.70%	62.50%

Homestead market assessments tripled in past six years

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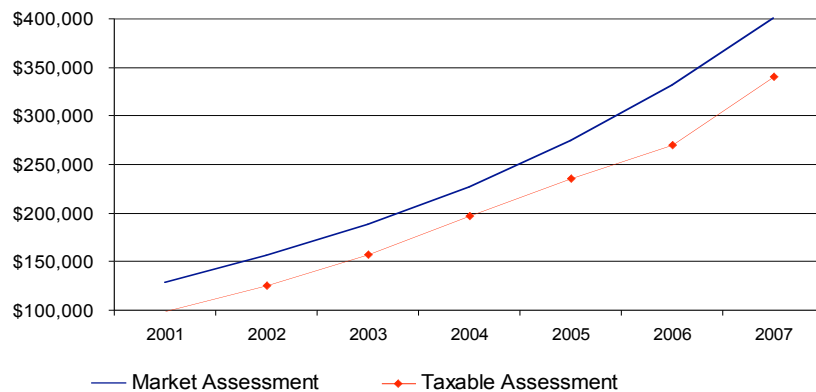
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Market Assessments and Taxable Assessments Under an Ad Valorem Tax DC's Median Homestead 2001 to 2007

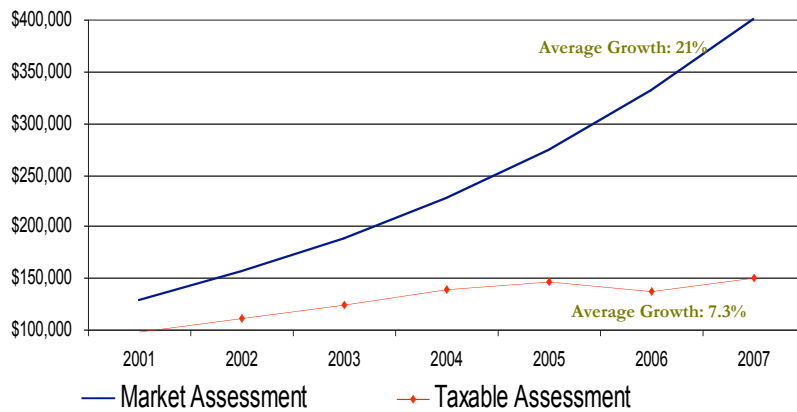


The market and taxable assessments are correlated over time

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Market Assessments and Taxable Assessments Under a Tax Cap Policy

DC's Median Homestead 2001 to 2007



The TCP severs the link between market and taxable assessments

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A Tax Cap Policy

- Shifts the property tax burden away from
 - Homes with the faster rates of appreciation
 - Long-time homeowners

- Shifts the property tax burden towards
 - Homes with the slower rates of appreciation
 - Relatively new homeowners

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Horizontal and Vertical Equity

Judging the fairness of a tax or tax system

- **Horizontal Equity** exists when similarly-valued properties have similar property tax burdens
- **Vertical Equity** exists when higher-valued properties tend to have higher property tax burdens than lower-valued properties

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Effective Tax Rates for Selected Market Assessment Levels Without TCP Scenario (WOTCP)

	Selected Market Assessment Levels	# of Homesteads in Assessment Range	2007 Effective Tax Rates		
			Low Value	High Value	Range
1	\$200,000 Range: \$195,000 to \$205,000	1,535	\$0.61	\$0.62	\$0.01
2	\$400,000 Range: \$395,000 to \$405,000	1,695	\$0.75	\$0.75	\$0.00
3	\$600,000 Range: \$595,000 to \$605,000	618	\$0.79	\$0.79	\$0.00
4	\$800,000 Range: \$795,000 to \$805,000	524	\$0.81	\$0.81	\$0.00
5	\$1,000,000 Range: \$995,000 to \$1,005,000	2,229	\$0.82	\$0.83	\$0.01
6	\$2,000,000 Range: \$1,995,000 to \$2,005,000	297	\$0.85	\$0.85	\$0.00
7	\$5,000,000 Range: \$4,995,000 to \$5,005,000	17	\$0.87	\$0.87	\$0.01

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Practically, no variation in effective tax rates at each assessment level

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1	\$200,000 Range: \$195,000 to \$205,000	1,535	\$0.00	\$0.62	\$0.62
2	\$400,000 Range: \$395,000 to \$405,000	1,695	\$0.03	\$0.75	\$0.72
3	\$600,000 Range: \$595,000 to \$605,000	618	\$0.01	\$0.79	\$0.78
4	\$800,000 Range: \$795,000 to \$805,000	524	\$0.08	\$0.81	\$0.73
5	\$1,000,000 Range: \$995,000 to \$1,005,000	2,229	\$0.07	\$0.83	\$0.76
6	\$2,000,000 Range: \$1,995,000 to \$2,005,000	297	\$0.18	\$0.85	\$0.67
7	\$5,000,000 Range: \$4,995,000 to \$5,005,000	17	\$0.39	\$0.87	\$0.48

Significant variation exists in effective tax rates at each assessment level ¹³

Classifying Homesteads by Number of Years in Tax Cap Program

Cohort	2007 Cap Status	Number of Years in Program	Tax Relief Received Via TCP
Cohort 1	Not capped	0	Not capped in 2007, ad valorem property taxation
Cohort 2	Newly capped	1	Not capped in 2006 but capped in 2007
Cohort 3	Medium-term capped	Between 2 and 5	Capped for years 2006 and 2007 but entered program after 2002
Cohort 4	Long-term capped	6	Capped since the inception of program in 2002

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Distribution of District Homesteads by Cohort in 2007

	Number of Homesteads	Homestead Market Assessment Value	Tax Liability (WTCP Scenario)	Relief Via TCP
Cohort 1	6.9%	6.7%	10.4%	0.0%
Cohort 2	10.5%	10.1%	13.3%	4.4%
Cohort 3	18.6%	19.0%	20.2%	17.1%
Cohort 4	64.0%	64.2%	56.2%	78.4%
Total	100.0%	100.0%	100.0%	100.0%

Cohort 4 has a relatively lower tax burden due to receiving the bulk of TCP relief

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Measuring Horizontal Inequity by Cohort and Market Assessment Level

2007 Market Assessment Value Range		Cohort 1	Cohort 2	Cohort 3	Cohort 4
Less than \$200,000	Share of Properties	0.5%	1.3%	1.1%	6.9%
	Median Effective Tax Rate	\$0.56	\$0.29	\$0.28	\$0.27
	Relief Percentage	36.1%	67.9%	68.3%	69.0%
Between \$200,000 & \$600,000	Share of Properties	4.6%	6.4%	11.7%	37.8%
	Median Effective Tax Rate	\$0.74	\$0.60	\$0.42	\$0.32
	Relief Percentage	16.0%	32.7%	53.2%	64.0%

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Measuring Horizontal Inequity by Cohort and Market Assessment Level (Cont.)

2007 Market Assessment Value Range		Cohort 1	Cohort 2	Cohort 3	Cohort 4
Between \$600,000 & \$1million	Share of Properties	1.3%	1.8%	4.2%	13.4%
	Median Effective Tax Rate	\$0.81	\$0.74	\$0.60	\$0.48
	Relief Percentage	8.4%	16.9%	31.1%	45.5%
Greater than \$1 million	Share of Properties	0.5%	0.9%	1.5%	6.0%
	Median Effective Tax Rate	\$0.84	\$0.76	\$0.66	\$0.56
	Relief Percentage	5.7%	14.6%	26.3%	37.0%

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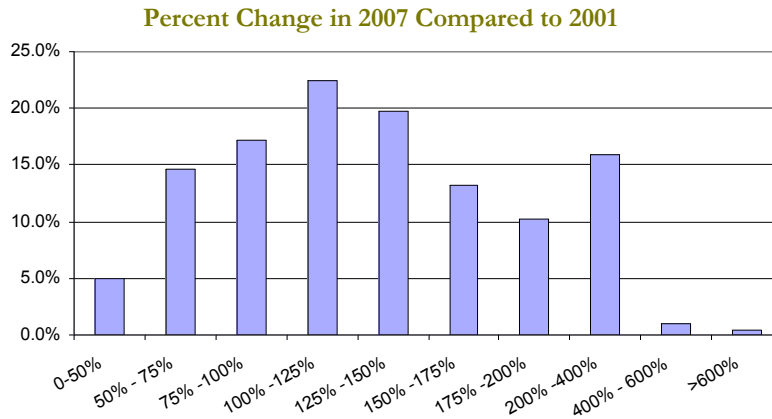
Measuring Horizontal Inequity by Cohort and Market Assessment Level (Cont.)

A Summary

2007 Market Assessment Value Range		Cohort 1	Cohort 2	Cohort 3	Cohort 4
Total	Share of Properties	6.9%	10.5%	18.6%	64.0%
	Median Effective Tax Rate	\$0.75	\$0.62	\$0.46	\$0.36
	Median Assessment Value	\$409,340	\$390,750	\$679,540	\$1,269,690
	STD of Effective Tax Rate	\$0.08	\$0.18	\$0.17	\$0.14
	Relief Percentage	15.4%	30.7%	47.8%	60.5%

The amount of TCP relief is highly correlated to number of years in program

Distribution of Cohort 4 Homesteads by Market Assessment Growth Rates



The market assessments for most homesteads in Cohort 4 more than doubled in six years.

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Comparing 2007 Market Values and Tax Burdens for Homesteads in Cohorts 1 and 4

Market Assessment Levels for Cohort 4 (Long-term capped) Homesteads	Selected Market Assessment Levels for Cohort 1 (Uncapped) Homesteads									
	\$100 K	\$200k	\$300k	\$400k	\$500k	\$600k	\$700k	\$800k	\$900k	\$1 million
\$200,000 - \$300,000		Yellow								
\$300,000 - \$400,000			Yellow							
\$400,000 - \$500,000				Yellow						
\$500,000 - \$600,000					Yellow					
\$600,000 - \$700,000						Yellow				
\$700,000 - \$800,000							Yellow			
\$800,000 - \$900,000								Yellow		
\$900,000 - \$1,000,000									Yellow	
\$1,000,000 - \$2,000,000										Yellow
>\$2,000,000										

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An ad valorem system fosters horizontal and vertical equity in property taxation

Comparing 2007 Market Values and Tax Burdens for Homesteads in Cohorts 1 and 4 (cont.)

Step 1: Determine Tax Burdens for Cohort 1 (Uncapped) Homesteads at Selected Market Assessment Levels

Market Assessment	\$100,000	\$200,000	\$300,000	\$400,000	\$500,000
Assessment Minus Homestead Deduction	\$40,000	\$140,000	\$240,000	\$340,000	\$440,000
Tax Bill	\$352	\$1,232	\$2,112	\$2,992	\$3,872
Effective Tax Rate (ETR)	\$ 0.35	\$ 0.62	\$ 0.70	\$ 0.75	\$ 0.77
Tax Relief Value	\$528	\$528	\$ 528	\$ 528	\$ 528
Relief Percentage	60.0%	30.0%	20.0%	15.0%	12.0%
Market Assessment	\$600,000	\$700,000	\$800,000	\$900,000	\$1,000,000
Assessment Minus Homestead Deduction	\$540,000	\$640,000	\$740,000	\$840,000	\$940,000
Tax Bill	\$4,752	\$5,632	\$6,512	\$7,392	\$8,272
Effective Tax Rate (ETR)	\$ 0.79	\$ 0.80	\$0.81	\$ 0.82	\$0.83
Tax Relief Value	\$528	\$528	\$528	\$528	\$528
Relief Percentage	10.0%	8.6%	7.5%	6.7%	6.0%

Comparing 2007 Market Values and Tax Burdens for Homesteads in Cohorts 1 and 4 (cont.)

Step 2: Obtain Tax Burdens of Cohort 4 Homesteads and Compare

Market Assessment Levels, Cohort 4 Homesteads	Selected Market Assessment Levels for Cohort 1 (Uncapped) Homesteads										Total	Share of Cohort
	\$100 K	\$200k	\$300k	\$400k	\$500k	\$600k	\$700k	\$800k	\$900k	\$1 million		
\$200,000 - \$300,000	7,251										7,251	14.9%
\$300,000 - \$400,000	8,789	4,052									12,841	26.3%
\$400,000 - \$500,000	3,909	2,804	91								6,804	13.9%
\$500,000 - \$600,000	1,534	2,435	95	14							4,078	8.4%
\$600,000 - \$700,000	725	3,098	232	44	6						4,105	8.4%
\$700,000 - \$800,000	421	3,045	233	39	11	5					3,754	7.7%
\$800,000 - \$900,000	252	2,266	239	46	3	4	3				2,813	5.8%
\$900,000 - \$1,000,000	128	1,356	180	39	12	10	1	1			1,727	3.5%
\$1,000,000 - \$2,000,000	193	3,330	896	274	57	26	14	9	6		4,805	9.8%
>\$2,000,000	24	373	161	42	9	5	3	3	0	1	621	1.3%
Total	23,226	22,759	2,127	498	98	50	21	13	6	1	48,799	100.0%
Share of Total Cohort	47.60%	46.64%	4.36%	1.02%	0.20%	0.10%	0.04%	0.03%	0.01%	0.00%	100.0%	22

A case of vertical inequity.

Comparing 2007 Market Values and Tax Burdens for Homesteads in Cohorts 1 and 4 (cont.)

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A case of horizontal inequity.

Possible Options for Addressing TCP-Induced Inequities

- 1) Eliminate the TCP and resort to annual tax rate reductions (e.g. truth-in-taxation) as a primary means of tax relief to offset tax effects of assessment growth
- 2) Keep the TCP, but reform how it is implemented

Reforming the TCP

- Replace a fixed tax cap rate structure with a “Tax Cap Cycle”
 - Use a combination of tax cap rates and tax rate reductions over time to limit growth in annual property tax bills
 - In years of decelerating assessment growth, gradually increase tax cap rate and continue tax rate reductions

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Conclusions

- Without meaningful tax rate reductions to offset the effects of significant assessment growth, voters seem to opt for a TCP
- In doing so, voters prefer a property tax system that fosters inequities to a conventional ad valorem system
- A TCP exacerbates property taxation inequities by
 - Severing the link between market and taxable assessments
 - Over reliance on the TCP to lower property tax burdens
- The tax cap rate, relative to the overall annual growth rate in market assessments, is also a determinant in the degree of inequities.
- Homeowners tend to be aware (and concerned) of the TCP-induced horizontal inequities but may not be aware of vertical inequities

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Conclusions (Cont.)

- ❑ Despite major shortcomings, a Real Property Tax with a Tax Cap is a legitimate and voter-supported form of property taxation
- ❑ However, reform to the TCP may be needed in order to maintain the long-term efficacy of the real property tax
- ❑ In DC, TCP-induced inequities are pervasive, affecting 93% of homesteads
- ❑ On average, the effective tax rate for long term capped homesteads is half the effective tax rate for uncapped homestead
- ❑ Over a third of homesteads that receive TCP relief are million dollar homes

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