

The Middle Way to Property Tax Reform

By Donald Nichols

*Director of the Robert M. La Follette School of Public Affairs,
and a professor of economics and public affairs
at the University of Wisconsin-Madison*

How can Wisconsin close its budget deficit?

The immediate causes of the deficit are twofold. First, along with many other states, our tax receipts fell when the dot.com bubble burst, and we now struggle to fund our growing needs from a shrinking tax base. Second, some bad budgeting decisions in Wisconsin postponed to the last biennium a confrontation with the deficit, which had swelled to more than \$1 billion. These immediate issues have put us in a deep hole.

The main drivers of the deficit are long term, however, and the sooner we confront them, the better. The costs of many state and local services, especially health care, are growing faster than state income. But taxpayers are unwilling to pay an increasing tab for these services. Something must give some day.

The battle over the short-term deficit could force a healthy debate about the long-term issues concerning how big government should be, how the public should fund it and how government efficiency can be improved. Wisconsin needs to decide which services should be provided publicly and privately.

An immediate issue driving the debate is irritation with the property tax.

Opinions on the property tax vary widely.

The education lobby, including the teachers' organizations, points to the need

to spend more on education. From the trenches they give us vivid examples of needs that current funding does not meet. Many in this group accept the property tax as a necessary evil because it is the way we pay for local education.

On the other side there is an anti-tax lobby with strong participation from the business community. This group feels that government is too big and too inefficient. They will propose ways to limit the growth of government, including education, so that publicly provided services become a smaller and smaller fraction of our economy.

This group, too, has vivid examples, especially of the effect of increased property taxes on retirees with fixed incomes. Indeed, many non-retirees are shocked and frustrated at large increases they have seen in their property taxes.

Is there a middle way? What compromises between these two positions should the residents of Wisconsin accept?

At a La Follette School conference on these issues that took place Jan. 19, 2005, I proposed a middle way to solve the property tax dilemma. I am aware that compromise proposals keep neither extreme happy, but my proposal may have some appeal to the average taxpayer.

The proposal has three parts. The first is to freeze the rate of growth of property tax payments on all farms and residences

The Middle Way to Property Tax Reform

2

to the rate of growth of income of an average Wisconsin resident.

The big advantage of this is that retirees — and others — will not be driven from their homes by the property tax. Even the most ardent supporter of increases in spending for education does not want to see retirees driven from their houses because of increases in their property taxes.

Because some districts would be frustrated by the inability to raise additional resources through the property tax, the second feature allows districts to set their mill rates as they do now and to benefit from increases in assessments.

Under the second provision, property tax payments that would otherwise be above the frozen limit - whether because of increases in property values or the mill rate — would be deferred until the property is sold.

The third feature of the proposal would have state government bond the deferred tax collections and remit the bonded revenue back to the local taxing authorities.

In this way the local authority would get the same revenue under the proposal that it would now get when assessments or mill rates change. That is, the amount of the increase that is less than the freeze would be collected directly from property owners, while the amount in excess of the freeze would be collected through the local authority selling the deferred tax claim to the state.

In turn, the state, which would own the claims to the deferred tax payments, could sell securities on Wall Street that are secured by the deferred claims.

When the deferred payments come due, which would be when the properties are sold, inherited, or converted to other use, the state would collect the payments and pay off the Wall Street bonds.

Thus the net cash received or spent by

the state would not change, the net cash the local authorities receive or spend would not change, and property taxpayers would have a portion of their payments automatically deferred if their taxes would otherwise increase faster than average incomes.

If written into legislation, the core of the proposal would be accompanied by a set of optional details. Each of these can be chosen in separate up or down votes without dropping the central ideas. My preference would include making participation optional. I would replace the taxation of farmland at use value with the proposed deferral. I would have the state charge interest on deferred tax payments at the same rate as the state pays to bond the deferrals. I would exempt seniors with incomes below \$25,000 from the interest charge. I would maintain existing local revenue caps. Each of these possibilities deserves individual attention, but the central ideas can be adopted regardless.

Middle way proposals are vulnerable to attacks from both sides. This proposal has no provision to increase education spending above what would otherwise be or to protect it from the growing cost of medical care, which threatens to eat up everything else in the state budget. So the education lobby will be disappointed.

The proposal does not cut the size of government from what it would otherwise be, so the anti-tax lobby will be disappointed. But it does keep people from being thrown out of their houses when property taxes rise, and it does protect a major source of revenue for local services, including education, police and fire, which are services that taxpayers want.

A shorter version of this essay appeared in the Jan. 16, 2005, Wisconsin State Journal under the headline "Let Homeowners Defer Property Taxes." For more information, see www.lafollette.edu.