EXECUTIVE SUMMARY

This report originally appeared in the Nebraska Tax Modernization Committee report, LR155, 2013. It describes the Nebraska property tax system and policies, compares it to other states property tax systems and policies, and illustrates how the Nebraska property tax compares to widely accepted tax policy principles. It also covers the results of past tax studies in Nebraska, including the Syracuse Tax Study, and addresses the observations of tax experts consulted by the Tax Modernization Committee. Finally, it includes the suggestions of citizens who appeared at hearings held by the Committee in 2013. It has been edited from the original and updated as necessary to reflect the most current data available.

I. **The Base of the Nebraska Property Tax**.

A. History. The Nebraska property tax as currently structured is primarily a tax on the value of real property, which can be described as real estate and improvements to real estate. Nebraska property tax laws also require owners of certain types of personal property to pay taxes on this value. Personal property includes business equipment and agricultural machinery. Nebraska generally exempts governmentally owned property, religious, charitable and private educational institution property under most circumstances.

In the last 45 years, the laws of Nebraska have been modified to exempt some property that was previously taxed. Exempt personal property now includes household goods like furniture, business and agricultural inventories, and intangible assets like stocks, bonds and bank accounts. In 1970 voters approved a constitutional amendment which allowed personal property value to be exempted and treated in a non-uniform manner. Some items of business personal property were removed from the tax system in the late 1970's, but were added back to the property tax system in 1992.

In 1972 voters approved a constitutional amendment which allowed agricultural land to be valued in a non-uniform manner relative to other property. Agricultural land can be valued at its market value for agricultural use under this provision. The voters passed a subsequent amendment of this same language in 1990, after a 1987 Nebraska Supreme Court decision invalidated agricultural land valuation practices in use at that time – an income-generating or income approach to valuation. This amendment authorized the current practice of valuation of agricultural land at a reduced percentage of its agricultural use market value. Today, Nebraska state law authorizes valuation of such property at 75 percent of market value in agricultural use.

Motor vehicle valuation and tax were separated from the ad valorem (or "based on value") property tax base after a constitutional amendment passed in 1998. Taxes are still paid on motor vehicles as a form of personal property tax. The tax is based on a statutory tax schedule which declines with the age of the vehicle, rather than value. The tax amount paid in the first year of existence is based on the manufacturer's suggested retail price. As a result, the tax paid on a motor vehicle is an amount which is now uniform across the state, regardless of local property tax rates. State law provides that this property tax is no longer part of the system of locally imposed rates on locally determined value. The tax is collected by the county treasurer in each county. Tax amounts go only to schools, counties and cities pursuant to distribution percentages found in state law.

Passage in 1998 of another constitutional amendment provided that governmentally owned property would continue to be exempt *if it was determined to be in a public use*. After this amendment, governmental land held primarily as investment property, including the land owned by the State Board of Educational Lands and Funds, was valued for tax purposes and made subject to property tax. Much other public land remains exempt based on a successful court challenge to this law. The Nebraska Supreme Court took the broad view that public ownership constitutes public use.

Over time, then, the base of the property tax as defined by constitutional and statutory law changes has been both narrowed and expanded as well as redefined. The base reduction or narrowing may have reduced the base by 15 to 20 percent from the law prior to 1970. However, Nebraska's property tax base for valuation remains broader than that found in most states. A broad base for taxation is generally viewed by economists examining a tax system as a sound tax policy principle.

B. Tax Relief Programs. Nebraska funds two direct relief programs for taxpayers. These are the homestead exemption program, which funds an offset to property taxes owed by low income elderly and certain disabled persons. The funding has grown over the past decade, as shown in the chart below. In 2014 just over 50,000 persons applied for the homestead exemption program.

Property Tax Chart 1

Homestead Exemption Program Funding

Tax Year	**Reimbursement**
2004	50,371,974.08
2005	54,066,315.70
2006	56,833,507.97
2007	62,818,595.66
2008	61,027,583.44
2009	65,849,847.78
2010	68,801,129.91
2011	68,801,129.91
2012	67,451,321.28
2013	65,087,563.54
2014	67,354,379.17

The state also funds a property tax credit levy rate offset program. This program had been funded at $115 million for each of the last several years. The program reduces the tax levy rate on each parcel of real property by a fixed amount. This is determined by dividing the total funding amount by the statewide real property value. The result is a credit of a fixed number of cents per one hundred dollars of value. The tax credit levy offset has decreased in effectiveness over the last several years as valuation levels increase and funding is frozen, as shown in the chart below.

Property Tax Chart 2

Nebraska Tax Credit Program

Tax Year	Levy Offset Percentage	Funding (in millions)
2007	0.08300	105
2008	0.08600	115
2009	0.08222	115
2010	0.07891	115
2011	0.07531	115
2012	0.07150	115
2013	0.06597	115
2014	0.07154	140
2015*	0.09520	204
2016*	0.09520	204

*The levy offset percentage for 2015 and 2016 are estimated.

For tax year 2014, an additional $25 million was added to the fund for a total of $140 million. And for tax years 2015-2016, an additional $64 million per year was added for a total of $204 million in property tax relief in each of the next two years.

Finally, LB259 was enacted in the 2015 legislative session. This bill creates the Personal Property Tax Relief Program. Beginning in 2016, every person required to file a personal property tax return is allowed an exclusion for the first $10,000 of value. State general funds will be used to reimburse local taxing districts for the lost revenue, at an estimated cost of $20 million. This is equal to approximately ten percent of the personal property taxes paid in 2014.

II. Review of Recommendations from Past Tax Studies

LR 155 asked for an examination of past tax studies, including a comprehensive study of Nebraska state and local finance, now commonly referred to as the Syracuse Tax Study, published in 1987. That study identified the following issues regarding the property tax in Nebraska, and made recommendations to address these issues.

A. The Base. First, regarding the system or structure of the property tax, the Syracuse study reviewed exemptions and the remaining base and found it structurally comparable and sound, relative to the recommended base for property taxation. The authors did recommend putting agricultural machinery back on the property tax list and restoring this value to the base. They also recommended exempting such machinery from sales tax. By doing so, they felt Nebraska would be achieving balance and consistency in tax treatment of property and sales tax. This policy recommendation was implemented in 1992 in regard to agricultural machinery property and sales tax. A related recommendation that manufacturing equipment be exempted was not implemented until 2005. The sales tax exemption for agricultural machinery repair parts was adopted by the Legislature in 2014.

B. Use of the Property Tax. The main focus of the Syracuse study was Nebraska's higher than average use of property tax in its tax system. Syracuse authors recommended reducing the role of property taxes in financing government services. The main policy option they identified was an increase in state aid to local governments. They reported that all Nebraska local governments experienced lower levels of state revenue sharing than local governments in other states. They advised retaining existing aid programs for all governments, and supplementing these aid programs with aid based on equalizing concepts. The equalizing concept they advocated involved uniformly measuring public services needs and comparison of community economic capacity to meet needs.

In regard to schools, the largest user of property tax revenues, the recommendation for increased aid was made with a caveat. The view of the Syracuse authors was that a consolidation of Nebraska's more than 900 school districts ought to precede any increase in aid. They believed fiscally stronger and more efficient school systems would result.

Three years following the Syracuse report publication, in 1990, the Legislature did implement a new school aid system which is based on equalizing needs and capacity, as measured by fiscal capacity of the property tax base. In that same year the Legislature passed legislation to require school district common levies, forcing affiliations of elementary and high school districts to financially support high schools. This began the long, and to some degree tortured, process of school consolidation. The system Syracuse criticized, involving over 900 districts with independent taxing authority and separate systems of elementary and secondary education has been reduced in size to 245 (2014-2015 school year) independent districts offering a comprehensive kindergarten to high school education supervised by the same elected board.

In regard to other governments, specifically cities and counties, Syracuse recommended that an increase in state sales or income tax revenue sharing be implemented. The view they reflected was that these taxes could be used to substitute for property tax use. They also recommended that the aid be based on equalization concepts. The suggested approach to making this transition was to make the change in a manner which forced a one year freeze on local property tax resources so the transition could be effective in the view of the taxpayer. In the case of school aid, increases mentioned above and made in 1990 effectively implemented this policy recommendation.

The Legislature was slow to increase its funding commitment to city and county aid. A property tax reform package developed in 1995 and put in place in 1998 did involve new forms of equalization aid and other state aid for cities and counties. Older aid programs put in place to mitigate property value capacity losses due to exemptions beginning in 1967 and continuing through 1980 were left in place.

This expanded commitment to aid to replace property taxes was decreased in 2010. Older capacity loss aid programs for cities and counties, and more recently created county aid programs were repealed to meet state budget cutting goals. School aid growth was also reduced at this same time.

C. Local Assessment Practices. Syracuse authors suggested other reforms, including a focus on quality of assessment practice. They found highly variable sales assessment ratios and other statistical measures such as the coefficient of dispersion at the local level. Following this suggestion, the Legislature in the late 1990's established a separate state administered property tax agency independent of the Department of Revenue. The new Property Tax Administrator was appointed to a six year term to lead the Department of Property Assessment and Taxation ("DPAT"). Laws regarding statistical standards to be achieved by each county and an annual review of compliance with those standards were passed.

For a brief period, state administration of county property valuation was implemented through a voluntary program. This effort, involving nine counties for a period of several years, has since been repealed. In addition, DPAT has been moved back under the purview of the Department of Revenue while the Property Tax Administrator remains an appointed position. The Tax Commissioner who is essentially the chief operating officer of the Department of Revenue is appointed to a four-year term.

The State Board of Equalization, consisting of elected state officials with other full time duties, was replaced by an appointed Tax Equalization and Review Commission ("TERC") around this same time. Members of that commission have a full time duty of hearing taxpayer appeals and reviewing county efforts to meet statewide equalization standards.

The Tax Modernization Committee requested a review of the statistics cited by Syracuse, and the current practices of counties. This has been done and will be the subject of a separate report. In general, we can report that these measures have improved, with more counties achieving the statistical results recommended by the Syracuse authors.

D. Property Tax Policy and Education Funding. Syracuse authors recommended against adopting certain property tax reforms or policies. These included classification or preferential assessment practices, which they believed violated principles of tax fairness and distorted the economics of taxpayer decision making. They suggested full market value assessment remain a standard, including for agricultural land. They suggested annual review of value level compliance be instituted.

The authors recommended repeal of tax rate limits, including the constitutional limit imposed on county governments. They also recommended repeal of city government tax rate limits, or simplification of these limits with an aid program to mitigate impacts on low capacity governments.

Syracuse authors noted that schools faced no levy limits at that time, although they were the largest user of the property tax. Schools, like all other governments in Nebraska, faced levy or rate limits from the time they were authorized by legislation. School levy limits for all schools were removed in the early 1950's. This was done as an alternative to providing greater state aid or revenue sharing for schools. A state aid to local schools program funded by a statewide property tax began in 1907, and was based on an equalizing of capacity and needs concept. This program was defunded in 1952.

Levy limits were removed at that time as an alternative to a greater state role in providing funding. A prohibition against a state government property tax, if a state sales or income tax was to be imposed, was also added to the Constitution in 1954. School consolidation committees and studies were also mandated at that time. Between that period of time, and the 1987 Syracuse recommendation for a school consolidation effort, the number of independent school districts dropped from over 7000 to the 900 examined by Syracuse authors.

In 1998, the Legislature renewed tax rate limits for schools, and dramatically reduced city tax rate limits. The county government fifty cent limit, which was established by a 1919 constitutional convention, was left intact. Counties were required to allocate levy authority to other county subdivisions like fire districts and townships under a modification of statutory county levy limits. Lower city levy limits imposed were accompanied by a larger commitment to city aid. School levy limits were imposed with an increased commitment to school aid. All three levy limit changes were implemented with revisions to aid programs which addressed high local rates due to low property tax fiscal capacity.

Finally, the Syracuse authors recommended the development of more detailed information on the finances of local governments. They suggested the state invest more heavily in this effort. In 1998, efforts to improve reporting were instituted in the State Auditor's office. An on line data report on city and county finances was the result, for both budgeted and audited data. This was done as a feature of implementing local budget, tax rate and revenues limits. Syracuse authors did not recommend budget or receipt growth limits, except in the year of transition to greater state revenue support to substitute for property tax use.

III. A Comparison of the Nebraska Property Tax to that of Other States

A. Use of the Property Tax. All states use a property tax in their state and local tax systems. For the most part, the property tax is used by local governments such as cities, counties, and independent school districts. Some state governments continue to use a statewide property tax. Article VIII-5 of the Nebraska Constitution prohibits Nebraska state government from using a property tax for state purposes.

The property tax represents the largest percentage share of total state and local taxes collected in Nebraska as illustrated below. These results are based on reports from the United States Census Bureau, the major source of information for state to state comparisons of taxation. The property tax share of total state and local taxes is higher in Nebraska than in other states in the nation, and higher than the six states which border Nebraska.

Property Tax Chart 3

Percentage Use of the Property Tax

	U.S Average	Nebraska	Border States
2010	33.12%	36.85%	34.20%
2012	32.14%	36.35%	31.59%

(Source: U. S. Census Bureau, State and Local Government, 2010 and 2012. http://www.census.gov/govs/local)

Were the Nebraska property tax share of total taxes to be reduced to the same share of total taxes as the national average, it would require a shift equal to 3.7 percent of the total state and local taxes reported in 2010. While this does not seem like a large change in state and local tax revenues, it does amount to a $200 to $300 million shift in the use of the $7.8 billion dollars of taxes reported by the Census Bureau for that year. This amount could represent as much as a 10 percent reduction in the use of the property tax in Nebraska. (The amount of tax shift varies based on whether average regional or national shares are a policy goal.)

The choice of how, or whether, to decrease or increase this share is an important one. Greater use of other taxes, or reductions in local property tax funding, have several consequences. These consequences effect who pays, but also impact the equity of the tax system, and the quality of public services. This choice could result in an increase in federal income taxes, as property taxes are an itemized deduction for federal tax purposes.

B. Comparing Tax Rates. In Nebraska, residential and commercial properties are assessed for tax valuation purposes at 100 percent of market value, or between 92 and 100 percent of market value for purposes of meeting statistical standards set by state law. Agricultural property is assessed at 75 percent of market value, or between 69 and 75 percent of market value in order to meet state standards of statistical accuracy. In many other states, it is often not the case that residential property is valued at 100 percent of its market value. The valuation of residential property for tax purposes is often subject to what is referred to as classification. This term commonly refers to treating one class of property differently from other classes of property for valuation purposes. In some instances, differential or classified rates are used as well.

One published source reports that residential property is valued at a reduced percentage of market value in 27 states. (Tax Rates and Tax Burdens Nationwide: 2011, Chief Financial Officer of the District of Columbia.) The "D.C. Burden Study" shows that average percentage level of market value in the U.S. is approximately 60 percent. And almost all cases, the level of value set out in state law is lower than that assigned to commercial property. Typically, commercial property is owned by small and large businesses, commercial apartment complexes, utilities, pipelines, railroads, and telecommunications companies. This policy effectively shifts the property tax burden to those properties, if all properties are taxed at a locally set and uniform tax rate.

In order to compare rates levied on property in different states, an effective rate must be calculated. This is done by dividing the amount of tax paid by the market value of a property. Because classification of residential property is common, residential property receives a “value preference“, but not in Nebraska. Two reliable public sources suggest that Nebraska has a high effective rate of tax on residential property. These are the D.C. Burden Study and “50 State Property Tax Comparisons” published by the Minnesota Center for Fiscal Excellence,

In the D.C. study, the report ranks the largest city in each of the 50 states, which is Omaha in Nebraska. In the Minnesota Center for Fiscal Excellence report, the ranking is based on the largest 50 cities in the United States, with 3 cities added to the list of rankings. Again, Omaha is in this group of ranked places. In both cases, for 2010, the residential effective rate in Omaha is shown as slightly over 2 dollars per one hundred dollars of market value. Omaha ranks 12th in both reports for 2010.

For subsequent years, Omaha ranks as follows in the D.C. Burden Study (2011-2013) and the Minnesota Study (2014 taxes due):

<u>Property Tax Chart 4</u>
<u>Ranking by Effective Rate</u>

Tax Year	**Effective Rate**	**Rank**
2010	2.18	12th
2011	2.09	13th
2012	2.09	14th
2013	2.11	11th
2014	2.032	12th

The residential preferential valuation classification used in other states is the major source of Omaha’s high relative rank. This policy of other states also reduces the share of the local tax base represented by the preferred class. In some cases, in particular the case of Colorado, the reduced market value is created by a policy of limiting valuation growth for the entire residential sector statewide. Colorado’s residential property is reported in 2010 for both these studies as assessed at 8 percent of its market value. Residential property is valued at just over 50 percent of its market value in Des Moines, Iowa, but taxed at a nominal rate of well over 4 dollars per one hundred dollars of taxable value. This results in a slightly higher effective rate of tax than that experienced in Nebraska, despite the lower level of market value taxed.

The Minnesota Center for Fiscal Excellence in their study of property taxes develops a ratio showing the amount of “cross subsidization” of residential property which results from this practice. The report shows that Omaha is one of 20 out of the 53 total ranked cities with little or no cross subsidization of residential property taxes by renters taking place. A similar ratio computation on urban industrial or commercial properties shows the same result of little or no cross subsidization.

One other important consequence of this policy is the reduction in the total dollar value of the tax base which is available to tax. Reducing value requires a higher rate to yield the same total tax revenue. In many states school aid systems local capacity is measured by examining taxable value. When classified and reduced property value is used in those states school aid formulas, the result can be higher levels of state funding to meet school needs. Accordingly, these states fund a higher percentage of local schools.

Nebraska's effective rates on agricultural land and its policy of reducing agricultural land value to a lower level of agricultural use market value cannot be so easily compared. In 1999, the Nebraska Legislature sponsored a study done by Dr. Bruce Johnson of the University of Nebraska which showed that agricultural land in Nebraska was taxed at the highest effective rate in the nation, despite this level of value reduction. The results of this 1999 study are not easily replicated, and no national organization regularly examines this issue in detail.

C. Comparing Property Tax Burdens on Household Income. The comparison of total household property tax amounts paid by Nebraskans to that paid by households in other states can be done through the D.C. Burden Study. These results suggest that low and moderate income households living in Omaha pay a lower amount of property taxes as a percent of income than the average household in the nation's largest cities. The results are shown below. The important variable taken into account in this study is the relationship between house value and income in these places. Midwestern cities like Omaha have lower ratios of house value to income. House values tend to be much higher on average then in Omaha. Persons with higher house value to income ratios will face higher taxes as a percentage of income.

Property Tax Table 5

Nebraska Property Taxes as Percent of Income – National Comparison

2011						
Income Family of Three	**Taxes - Nebraska**	**Taxes -- US Average**	**Nebraska as % of Income**	**US Average % of Income**	**Average v. Nebraska**	
25,000	1,618	1,891	6.47	7.56	16.9	National Average higher
50,000	2,579	2,686	5.16	5.37	4.1	National Average higher
75,000	2,962	3,092	3.95	4.12	4.4	National Average higher
100,000	3,416	3,045	3.42	3.05	-10.9	National Average lower
150,000	4,252	4,067	2.83	2.71	-4.4	National Average lower

2012						
Income Family of Three	Taxes - Nebraska	Taxes -- US Average	Nebraska as % of Income	US Average % of Income	Average v. Nebraska	
25,000	1,258	1,657	5.03	6.63	13.17	National Average higher
50,000	2,793	2,588	5.59	5.18	-0.73	National Average lower
75,000	4,190	3,967	5.59	5.29	-0.53	National Average lower
100,000	5,586	5,358	5.59	5.36	-0.41	National Average lower
150,000	8,379	8,132	5.59	5.42	-0.29	National Average lower

***NOTE: In the introduction to the 2012 report, the authors state, "In particular, the assumptions and methodologies used to estimate house values by income across the cities is <u>new to this report</u>, and as such has implications for the findings. " Thus, the significant increase in taxes paid both in Nebraska and in the national number, as compared to 2011.**

2013						
25,000	1,661	1,942	6.64	7.77	11.69	National Average higher
50,000	2,789	2,605	5.58	5.21	-0.66	National Average lower
75,000	4,183	3,978	5.58	5.30	-0.49	National Average lower
100,000	5,577	5,354	5.58	5.35	-0.40	National Average lower
150,000	8,366	8,189	5.58	5.46	-0.21	National Average lower

IV. <u>Base and Tax Growth in Nebraska</u>.

The rate paid in Omaha in 2011 was 2.1800, a rate higher than that paid on average in cities across Nebraska. A 2.0800 rate is common in incorporated places in Nebraska. House value to income ratios are often lower in communities smaller than Omaha. Rates are higher in suburban areas of Douglas and Sarpy County where sanitary improvement districts tax at a rate which is typically 30 to 40 cents higher than combined rates in adjoining cities.

As Chart 6 below shows, residential property no longer represents the largest share of taxable value but does still represent the largest share of taxes paid in the Nebraska system. As can be observed, the residential share of value and tax began to decline in 2008, after rising from 2002 to 2007. The increase reflected the housing boom and new construction value over that period, with the subsequent decline in housing value and new construction beginning at roughly the same time as the Great Recession. It also reflects the rising share of agricultural land value and taxes as a share of statewide amounts over the period 2007 to 2014.

Rates are also shown, and rising rates were evident on residential and business properties up to 2012. The 2002 to 2012 rate increases reflect in part the increase in school levy limits which were part of the budget reductions following the 2002 recession. At that time the school tax rate or levy limit was raised by five cents. Lower value growth and actual decreases in large urban areas, combined with sales tax revenue declines for cities, also shows up here in higher combined property rates on residential property.

The difference in the rates shown for agricultural land, versus the 2.000 or more rates on residential and business property, is explained by the fact that very little agricultural land is located inside the incorporated limits of cities levying a property tax. The city property tax adds 40 or more cents to the combined levies faced on residential or commercial property. The vast majority of both types of property is located inside incorporated city limits. Personal property value is a combination of business equipment, agricultural machinery, and the personal property value of railroads, pipelines, and telecommunications companies. Because much of this personal property value, including railroad value, is located outside the limits of an incorporated city and their added rates, the average rates on this type of property are lower than the rates on urban residences and commercial businesses.

The valuation and tax shares of the Nebraska property tax system for different types of property value are shown in Chart 6. Types shown here are residential, agricultural, other business, and business and agricultural personal property value.

Property Tax Chart 6

Property Tax Data for Nebraska by Sector

Residential Real Property Value, Tax Share and Statewide Rate			
	Share of Value	Share of Tax	Rate of Tax
2002	49.3%	52.3%	2.0158
2007	52.5%	55.1%	2.0532
2012	44.4%	48.8%	2.0887
2013	41.6%	46.9%	2.0833
2014	38.3%	45.3%	2.0458
Agricultural Real Property Value, Tax Share and Statewide Rate			
	Share of Value	Share of Tax	Rate of Tax
2002	23.7%	19.9%	1.5995
2007	22.7%	19.5%	1.6840
2012	30.4%	25.0%	1.5600
2013	34.3%	27.4%	1.4734
2014	39.4%	30.2%	1.3248

Non-Ag Business Real Property Value, Tax Share and Statewide Rate			
	Share of Value	Share of Tax	Rate of Tax
2002	19.1%	20.1%	2.0001
2007	19.1%	19.8%	2.0267
2012	18.3%	19.8%	2.0552
2013	17.3%	19.3%	2.0508
2014	15.9%	18.5%	2.0095
Personal Property Value, Tax Share and Statewide Rate			
	Share of Value	Share of Tax	Rate of Tax
2002	7.8%	7.7%	1.8749
2007	5.8%	5.6%	1.9052
2012	6.8%	6.4%	1.7937
2013	6.9%	6.4%	1.7335
2014	6.5%	6.1%	1.6280

Sources: Nebraska Department of Revenue, Certificate of Taxes Levied (2002, 2007, 2012 to 2014), Legislative Fiscal Office, DPAT Summary Data

The last category, business equipment personal property value, is a category of value not taxed in several states, including some border states of Nebraska. Several of these states have eliminated the taxation of business equipment and agricultural machinery. These states generally have also eliminated the valuation and taxation of household goods and business inventories, as Nebraska has also done.

The 1987 Syracuse tax study estimated that the base narrowing described earlier in this report, removing household goods, and business and agricultural inventory, reduced the base and yield by a factor of 18 percent. As noted earlier, the agricultural machinery value which was partially and then fully exempted in the later part of the 1970's was restored to the base in 1992, as a means of resolving lawsuits brought by other businesses which had continued to pay property taxes on this type of value. Today, all personal property value and business equipment constitutes a 6 to 7 percent share of value and tax, as shown above.

V. Characteristics of a Balanced and Moderate State and Local Tax System.

In examining Nebraska's state and local tax system the Tax Modernization Committee examined several reports on tax policy principles, and the policy recommendations made by analysts that have examined tax systems in the context of these principles. The primary report reviewed early in the Committees working session is titled *Characteristics of a Balanced and Moderate State-Local Revenue System*, by Robert J. Kleine and John Shannon. This work, written in 1986, describes some general policy principles, and characteristics, which policymakers should consider.

A major emphasis of these authors was the need for balance in the use of different types of taxes. This observation is based on the idea that each method or means of taxation contains weaknesses or flaws. Overuse, or higher than average use, of a particular tax type may emphasize its flaws. The authors suggested a broad guideline for percentage shares of total state and local taxes used, with major taxes representing approximately equal shares of the total of state and local taxes. In their view, property taxes should represent no more than 30 percent of the total taxes used in a state and local tax system. Income and sales taxes, in their view, should each represent between 20 to 30 percent of the total taxes. Other tax types, such as special excise taxes, like motor fuel and tobacco products, would make up the remainder of the system. In some states, energy severance taxes would represent a significant share of these other taxes. At the point the authors wrote this article, Census Bureau data suggested that average state use of the property tax was just over 30 percent. At that same point in time, Nebraska's use of the property tax was over 40 percent, a fact which was suggested as a problem in the Syracuse Tax Study.

The authors of both these reports suggested that in regard to the property tax, states would be best advised to focus on reduced use of the property tax and more use of relief mechanisms that relied on providing statewide collected resources, like sales or income taxes, distributed to local property taxing governments. In Kleine and Shannon's view, the state, with sales and income tax resources, should be the larger contributor to the funding of services like education and health care. They stated the policy framework in these terms:

> If the state prefers a more decentralized fiscal approach, it can share, unconditionally, a substantial part of its revenues with its localities on an equalizing basis. It should also be noted that local revenue diversification stands out as the preferred way to keep property tax at reasonable levels if local political accountability is favored over inter-local fiscal equalization.

Achieving balanced tax shares can be established as a tax policy goal. Nebraska currently makes use of a lower level of property taxes as a share of total taxes than it did 30 years ago when these two reports were written. The share reported here, just under 37 percent, is higher than the national or regional average, although the gap has narrowed over time. This is a result of overall increased state aid to local taxing entities in Nebraska, and recent trends in other states of increasing shares of property tax use. Property taxes have increased faster during the past ten years as an outgrowth of the housing boom, and the income and sales tax shares have become smaller as the economy has slowed dramatically in the wake of a national and international recession driven in large part by the housing sector financial meltdown.

Over the past 40 years state policymakers throughout the nation have responded in a variety of ways to concerns about rising property taxes. Much of this response was generated by the implementation of Proposition 13 in California and a similar limitation passed in Massachusetts. The responses have included increased use of classification, or value preferences for the residential class of property. Limitations on local spending, tax rates, and tax revenue growth have become widespread. Defacto classification or value preferences have emerged or been the result of class or parcel specific valuation growth limits. In the case of agricultural land, methodologies that avoid use of real estate market values in favor of commodity prices and derived capitalization rates have been developed to set value. The consequences of the latter approach have become evident in those states, like Iowa, where commodity price increases have driven value increases at a rate that match or even exceed the real estate market derived value growth.

Strategies or policies for structuring a tax system that experts view as effective are those that create a minimum of distortions in a market economy. Policies that lead taxpayers and policymakers down a path which requires constant adjustment or readjustment to changing political circumstances are generally not recommended. Stability in tax policy is highly valued.

Nebraska's property tax policy provides a stable and broad base which responds to economic growth. The impact of this tax on the economy of a place, and its public services, can be controlled and guided by local officials. State policies which take into account and compensate for relatively low local capacity to deliver public services can assure access to adequate services throughout the state, while avoiding excessive tax rate burdens on any one area.

VI. Recommendations from Citizens Participating in Public Hearings of the Tax Modernization Committee.

Over 1000 persons attended hearings of the Tax Modernization Committee. Testimony was taken from over 250 persons. Property tax issues were the main focus of a majority the testifiers. The testimony on property taxes focused on these policy issues:

- Rates of growth in property tax that exceeded growth in annual household income;
- Valuation practices that were viewed as inaccurate;
- High rates of growth in taxable values for agricultural land;
- State government mandates that shift costs to local property tax governments; and
- Reductions in state aid that shift local government to rely on other revenue sources including sales tax, occupation taxes, inheritance taxes and user fees.

VII. CONCLUSIONS OF THE TAX MODERNIZATION COMMITTEE FROM REVIEW OF THE PROPERTY TAX

A. Findings

1. Nebraska makes greater use of the property tax to fund public services than other states in the nation or region. Achieving the same average balance of sources in the region or nation would require a $200 to $300 million shift away from and reduction in the use of the property tax.
2. Nebraska property tax effective rates on residential and agricultural property are higher than averages for the nation or the region. This is largely due to valuation preferences for these property types found in other states, including the majority of states in our border region.
3. Property tax effective rates for agricultural land owners are 150 to 300 percent higher than the level of effective rates in three of our border states. Property tax effective rates for residential property owners exceed the national average by 44 percent. Property tax effective rates on urban commercial properties exceed the national average by 6 percent.
4. Nebraska property tax burdens on household income are <u>below</u> national average levels for low and moderate income households. These amounts are 5 to 10 percent <u>higher</u> than average for higher income households.
5. Nebraska policies to shield low income elderly and disabled households from high property tax rated and burdens on income are effective and useful. House value levels are indexed to county

averages. House value levels for inclusion in the homestead program have been revised in recent years. Income guidelines established 10 years ago have been indexed to inflation.

6. Nebraska's property tax credit was losing its effectiveness to reduce property taxes. This occurred as the level of state funding was frozen, while value continued to rise. Recent increased funding has also increased the effectiveness of the credit. Defunding the credit system would raise effective property tax rates and tax burdens on property owners. As funded through 2013 the credit reduced property tax rates and burdens by three percent for most urban property owners and four percent for most rural property owners.
7. Nebraska's property tax revenue growth has exceeded the rate of other tax growth in a recent time period when income and sales tax growth has slowed due to two successive recessions. Property tax growth in Nebraska is lower than that found nationally. It exceeds growth in the economy, as measured by personal income.
8. The quality of property tax valuation practice has improved since the Syracuse tax study was published in 1987.
9. The primary policy option for reducing property tax use recommended by the Syracuse Tax Study was increased aid to local governments, emphasizing equalization aid for local governments. This was to supplement the then existing aid programs, which had been implemented to offset loss of property tax capacity from prior exemptions granted. The recommendation was implemented in part. The preexisting aid programs which Syracuse recommended retaining have been repealed.

B. Recommendations

1. Increase state aid commitment to schools to offset property tax use and reduce property taxes as a share of total state and local taxes.
2. Reduce agricultural land value percentages to reduce the amount of tax on this value.
3. Raise homestead exemption program income guidelines to increase the number of persons who would benefit from this form of relief.
4. Offset the regressivity of the property tax by providing property tax relief to households having a higher burden of property tax on their household income. Consider circuit breaker programs for renters, high property tax burden households, and farm owner operators.