

Splitting The Difference

Residential And Business Property Taxes In Texas

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Published January 2004.

For the last decade an issue regarding school finance receiving a lot of attention is the share of total public education spending that has been borne by the state, which is less than half. This, despite ever increasing state expenditures in education.

Partly in response to this fact the 75th Legislature (1997) devoted a considerable part of the state's then-burgeoning budget surplus to public education and sought to reduce the local property tax burden by lowering property tax rates and tripling the homestead property tax exemption. Still, even during the biennium after the 1997 regular session, the state's share of public education spending never exceeded 47.2%. Though the state was supposed to take on better than a 50% share of public education funding, rising property values and the willingness of school trustees to increase tax rates prevented it.

Today, the lion's share of public education spending on the Foundation School Program is borne at the local level and that share has been growing. According to the Legislative Budget Board, in fiscal 1998 the state bore its largest share over the last decade at 47.2%. In fiscal 2000, the state's share stood at 47%. Since then, the state's share of public education funding has markedly declined so that in fiscal 2003 it stood at 39.7%. The state's share of public education spending is projected to decline again to just over 36% in fiscal years 2004 and 2005.

The goal of increasing the state's share of funding for public education spending may or may not be worth pursuing. However, another goal of public education finance reformers is to eliminate the so-called Robin

Hood school finance scheme whereby property wealthy (when wealth is measured on a per-student basis) school districts have significant sums of property tax revenues diverted to school districts that are relatively property poor. The only way to accomplish this goal is to significantly increase the state's share of public education spending.

The goal of eliminating Robin Hood cannot be accomplished with budget surpluses. Past surpluses disappeared and suddenly became a \$10 billion projected deficit in 2003. More importantly, the Robin Hood system exists due to spending inequity across school districts that naturally results from a system heavily dependent on local property taxes. Ending Robin Hood requires less dependence on locally-raised property taxes. For the state to shoulder a significantly larger burden with respect to public education, it must increase state-collected taxes in some way while simultaneously reducing the local property tax burden.

Several potential state taxes have been proposed. Among these are an income tax, a gross receipts tax, a business activities tax, a broadened and/or increased sales tax, and some kind of state-imposed property tax. An income tax and a statewide property tax would each require a constitutional election since both are prohibited under the state's constitution. Texas is currently among 12 states that have no property tax of any kind at the state level.

One of the more talked about tax proposals is a split roll property tax. The most commonly understood structure of a split roll property tax is one whereby real and personal business property is "split" from real residential property.

Typically, business property is taxed by the state using a legislatively-established property tax rate, while residential property is taxed locally. This structure would only apply to school taxes. City, county, and special district taxes would continue to apply uniformly

at the local level to business and residential property, but since the bulk of property taxes are school taxes, a split roll system would represent a major change in property tax policy.

The reason such a change is desirable to some is clear when one considers that almost half (\$559 billion) of Texas's \$1.16 trillion in total property value is business property even when multi-family dwellings (apartments) are included in the residential category. In fiscal 2002, \$14.4 billion in local property taxes funded public schools. Half that could be funded by a state business property tax (with no exemptions or deductions) at a rate of \$1.32 per \$100 valuation, using the Comptroller's 2002 valuation for all property in the state.

The creation of a split roll property tax can be likened to a shell game. A split roll tax system does not, in itself, necessarily result in lower property taxes. It simply converts what was once local tax revenue into state tax revenue by moving business property from the local tax rolls to a new state property tax roll. For an overall property tax decrease to occur for both business and residential property owners, some other tax will have to be increased or created.

Since the exact details about whether or not the overall property tax burden would change are not known, only the concept of a split roll tax in isolation is considered here. Such a policy change can be analyzed in several different ways and there are three perspectives that are considered here. First is from a purely economic efficiency perspective. The question to be answered from an efficiency perspective: to what degree is a split roll system likely to result in a misallocation of resources through tax-instigated changes in the relative costs of goods and services when compared to the current system's effects on allocation?

A second perspective from which a split roll system can be analyzed is also economic – the public choice

Veritas – May 2004

perspective. Public choice analysis uses economic tools and assumptions to analyze government behavior. This makes it possible to get some idea of how a split roll system might change over time by considering the incentives it inherently produces for decision makers tasked with funding government. It helps us understand the potential effects of a split roll system for the state as a whole in the long run.

Finally, there are the practical aspects of such a system. Texas has a strictly local property tax system with an institutional structure already fully in place. There are practical considerations involved in transitioning to a system of statewide property taxation which also must be considered.

This publication is available online at:

<http://www.texaspolicy.com/pdf/2004-01-26-sf-splitroll.pdf>
