

BRIEFINGS



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Analysis of the Constitutional Property Tax Proposals of the Florida Taxation and Budget Reform Commission

The Florida Taxation and Budget Reform Commission (TBRC) meets every twenty years and has the unique ability to send proposed constitutional amendments directly to the voters. The Commission is given a broad scope, including any issue that impacts Florida's fiscal policies. During the year leading up to the convening of the TBRC, Florida TaxWatch identified property taxes as the most important tax issue the Commission could address, even recommending that the Legislature defer the task of developing reform proposals to the TBRC.

The legislature did not wait and instead proposed Amendment 1 to the voters and the voters approved it. Even its most ardent supporters conceded that it would not solve the property tax system's problems and that it should be only the "first step." Others, including Florida TaxWatch, contended that it was not really reform and could make the central problems of the system - inequities and tax shifting - even worse.

Following the resounding passage of Amendment 1, it now appears the Legislature will not attempt any major property tax reform this session. Although the focus of the TBRC also moved away from big property tax changes, a few proposals have emerged.

On Monday, March 17, the full Commission will consider five constitutional proposals relating to property taxes. Each proposal has cleared all committees of reference and is now ready for final approval. One proposal is an attempt at major reform, while two similar proposals look to provide major property relief in exchange for increased sales taxes. Two others address narrower, but very important, issues.

The following is Florida TaxWatch's analysis of these constitutional proposals.

Constitutional Proposal (CP) 21 – Property Tax Exemptions and Assessment Limits

This is the only proposal before the TBRC that attempts comprehensive reform of Florida's property tax system. It strives to deal with the inequities and tax shifting that occurs in the current system. It contains some of the concepts of Florida TaxWatch's property tax reform recommendations – an assessment cap for non-homestead properties that is at least comparable to the Save Our Homes (SOH) cap and the use of a standard, minimum exemption for all taxpayers, that is replaced as the taxpayer's assessment cap savings grow.

The proposal would:

- 1) Retain the original \$25,000 homestead exemption.
- 2) Replace the additional \$25,000 homestead exemption recently approved by Florida voters (Amendment 1) with an exemption equal to 12.5% of the home's just value in 2009 and 25% of the home's just value in 2010 and thereafter. Each year, taxpayers would receive this new exemption or their Save Our Homes savings, whichever is greater.
- 3) Provide a new exemption for non-homestead residential property equal to 12.5% of the property's just value in 2009 and 25% of the property's just value in 2010 and thereafter. Each year, taxpayers would receive this new exemption or their assessment cap (see #4) savings, whichever is greater.
- 4) Provide a 5% assessment cap for non-homestead properties which would work the same way SOH did before Amendment 1 – the property would be assessed at just value if improved or if ownership changes.
- 5) Provide a temporary one-half percentage point increase in the sales tax for a three-year period (2009 through 2012). The increase would be dedicated to school districts to compensate for the revenue losses caused by this proposal. Any taxes in excess of what is required by the school districts could be distributed to other local governments (there would only be a surplus in the first year).

CP 21 attempts to address the inequities the current system creates for non-homestead properties and new home buyers. These are the taxpayers—businesses, landlords/renters, second home owners, snowbirds, etc.—that have shouldered most of the burden for rapidly increasing property taxes, and who were largely ignored by Amendment 1.

The concept of providing a standard minimum exemption that is used until a property's assessment cap savings reach that level is a good one. Having a minimum amount of a home's value protected from taxation will decrease the inequities between similarly situated properties and reduce taxes for new homeowners.

Providing the exemption to non-homestead residential property as well provides relief to a neglected segment of property taxpayers. The exemption also provides a measure of portability by assuring that a significant portion of the value of the new property would be exempt, instead of being assessed at full value. In fact, this is a more constitutionally sound method of providing portability than Amendment 1.

However, this minimum exemption concept should be extended to all non-homestead property (residential and commercial). The 5% assessment cap provided in this proposal is a welcome improvement for non-homestead property. The 10% cap provided in Amendment 1 is simply too high to do much about the tax shift to non-homestead property. However, without the minimum exemption, the same inequities created by SOH for homestead properties would be created among non-homesteads. The proposal provides the exemption to non-homestead residential property, but not commercial. This would result in a major shift of tax burden from the vast majority of taxpayers to properties not benefiting from this proposal—new commercial construction and businesses that relocate or expand. There would be no portability, so businesses that relocate would be assessed at full value. Higher taxes on new construction and relocations could have a negative effect on commercial real estate and significantly different tax bills for similarly situated businesses raise competitive concerns.

Extending the standard exemption to commercial property would increase the fiscal impact of the proposal, which is now estimated at \$4.2 billion (12.6%) in the first year of the full 25% exemption. The non-homestead residential exemption is estimated at \$2.7 billion. The total just value of commercial property in Florida is much less than that of non-homestead residential so the added impact would be considerably less than \$2.7 billion.

The proposal would also levy a temporary half-cent sales tax increase for three years, which would raise approximately \$2 billion annually. It is intended to help mitigate the impact on schools, providing enough to reimburse schools totally in the first year and mostly reimburse them in the next two years. The idea is to allow time for the legislature to decide how to handle school funding.

Generally, Florida TaxWatch finds that swapping sales taxes for property taxes is not in the best interest of Florida's economy (see analysis of CPs 02 and 50). However, in light of recent property tax relief and the economic downturn and resultant state revenue losses, the impact on local governments, and especially the ability of the state to hold schools harmless, needs to be addressed. The tax reform potential of this proposal should outweigh the tax relief aspects. In the previous two property tax relief plans passed by the legislature, an increase in millage rates would result in further shifting taxes to those who have paid the most. In this proposal, by contrast, allowing local governments and the legislature to increase millage rates to offset some of the impact on local governments and schools would redistribute the tax burden more equitably.

Florida TaxWatch conclusion. CP 21 would have been a much more comprehensive and preferable alternative to Amendment 1. It still has the potential make Florida's property tax system more equitable and sustainable. The standard exemption provided in the proposal for homestead and non-homestead residential property needs to be provided to commercial property as well. It would also likely strengthen the constitutionality of Save Our Homes and the recently enacted portability provisions.

Florida TaxWatch predicted that the passage of Amendment 1 would make future attempts at true reform more difficult, because it would be hard to develop a proposal to help non-homestead property that would garner enough homesteader support at the polls. This is proving to be true but CP 21 is a very good effort, and should proceed to the people. The only taxpayers that do not benefit are long-time SOH recipients, who already have the state's lowest tax burdens.

CP 02 and CP 50 – Replacing Required Local Effort School Property Taxes with Other Sources

Both of these similar proposals would replace the required local effort school property taxes set by the legislature with a combination of sources, relying mostly on sales taxes. Both proposals also provide a 5% assessment cap for non-homestead property.

Required local effort (RLE) are the property taxes that the legislature requires school districts to levy in order to participate in the state's school funding program. The amount of RLE is set each year in the General Appropriation Act. The legislature mandated \$7.9 billion in RLE in 2007-08.

RLE has been a major contributor to increased property taxes in Florida in recent years, more than doubling since 2000. The legislature has included a property tax increase in every recent budget, and local effort has become a bigger portion of school funding. RLE millage rate setting is also not as transparent as other local government millage rates. Florida TaxWatch has recommended reductions in RLE as the best way to give equitable property tax relief to all taxpayers. However, this proposal does raise significant concerns.

CP 02 would replace RLE funding by 1) raising the sales tax rate up to 1%; 2) eliminating exemptions from the sales tax; 3) state spending reductions; and 4) revenue increases resulting from economic growth due to property tax reductions. CP 50 adds "other revenues identified or created by the legislature" to this list of options. The option of taxing services was amended out of a previous version of CP 02.

This proposal would affect only RLE, other school property taxes such as the constitutional voter-approved millage or the discretionary millage authorized by the legislature would remain.

Past Florida TaxWatch research has shown that swapping property taxes for sales taxes dollar-for-dollar produces some negative economic impacts, due in part to the federal tax deductibility of property taxes. The TBRC economist's analysis of CP 02 supported this finding, predicting a loss of jobs, gross state product, and disposable income. It must be noted that a subsequent analysis commissioned by the TBRC by another economist contradicted the first assessment. Uncertain economic impact aside, the proposal is still problematic.

CP 02 would replace RLE in 2011-12, while CP 50 makes the switch effective in 2010-11. CP 50 mandates that the replacement revenue will equal at least the amount of RLE required in the 2008-09 budget, which will be passed during the current legislative session. It is not known how much that will be. The 2007-08 amount was \$7.9 billion and an increase is not unlikely due to the Legislature's desire to hold schools harmless from Amendment 1 combined with the current state revenue shortfall. The Governor has recommended \$8.3 billion. CP 02 does not specify the replacement amount, so it would presumably be the amount required in 2010-11, which would likely be considerably higher.

This raises the question as to whether the options specified are enough to replace the RLE. The TBRC staff analysis and economic analysis use \$3.9 billion as the value of a 1% sales tax increase in FY 2007-08. This number is based on old revenue estimates and the current reductions in the state's official estimates bring that number down to \$3.3 billion. Under current projections, it will not be worth \$3.9 billion until 2010-11.

The \$3.9 estimate comes from the *Florida Tax Handbook*, which is produced by the legislature. It cautions that the estimate does not account for decreased demand due to a price increase. It must also be recognized that a portion of sales tax collections are diverted to specific uses, including local governments. Only 89% of collections go to general revenue. Statutory changes would be necessary to have 100% of the sales tax hike go to replace RLE. A 1% increase would produce less than half of the needed replacement revenue.

This situation would put a lot of pressure on the legislature to repeal sales tax exemptions. The proposal excludes most exemptions (in terms of dollar value) from consideration, including food, and prescription drugs, residential rent and utilities. This leaves approximately \$4 billion of exemptions "on the table;" however that figure includes a significant amount of structural exemptions that are likely not (or are prohibited by law from) being repealed, not to mention exemptions for religious and non-profit organizations, school textbooks and lunches and other popular exemptions.

The remaining exemptions also include many important economic development ones. Economists believe it is critical to employ a tax system that both encourages maximum economic growth and generates revenue from economic growth. In other words, Florida's tax structure should encourage productivity—not tax it—while generating revenue from consumption. Florida TaxWatch has found that a number of these exemptions, especially those for inputs to production and incentives for developing industries are important for fostering a robust economy in Florida; these include exemptions for machinery and equipment for new and expanding business, electricity used in manufacturing, research and development, cogenerated energy, the space industry and the film industry. These and other exemptions have been cited by the state economic development arm—Enterprise Florida—as being critical to successful economic development in Florida.

This highlights the fact that the contention that there are billions of dollars of exemptions that are unjustified loopholes is incorrect. Forcing the legislature to repeal a significant portion of current exemptions is likely to produce some counterproductive results.

The values of the various exemptions, again taken from the *Florida Tax Handbook*, are just estimates. The *Handbook* cautions that there is overlap among the exemptions and repeal of numerous exemptions may not produce the full value of the individual estimates.

Even with a 1% rate increase and a repeal of most of the available exemptions, more money will be needed to replace RLE. The option of “revenue increases resulting from economic growth due to property tax reductions,” is likely not going to help. It would be very difficult to identify such revenue with much certainty and, in fact, there might not be much, at least in the first few years. And while state spending reductions should always be the first option explored, after the legislature is done cutting at least \$3 billion this year and next, this option may not produce much more.

Lastly, the 5% assessment cap provided in this proposal is needed. However, by itself, the same inequities created by Save Our Homes for homestead properties would be created among non-homesteads. CP 21 (see above) is a better approach to this problem.

Florida TaxWatch conclusion. CP 02 and CP 50 are well intentioned attempts to reduce the burden of required local effort property taxes without reducing school funding; however, this approach could have serious consequences for taxpayers, Florida schools, and the state’s economy. The economic impact of replacing property taxes with sales taxes is at best debatable, at worst detrimental.

Florida’s history with making tax changes to raise specific revenue amounts, instead of because they are the right long-term changes, should give pause. The unitary tax, the services tax, and the alcoholic beverage surcharge are examples of what happens when only revenue considerations drive tax changes. A deliberate, comprehensive review of sales tax exemptions would be better accomplished with SR 29 (already passed by the full TBRC) and CP 07.

The pressure to repeal exemptions could result in the state losing valuable economic development tools that better enable Florida’s businesses to compete successfully in an increasingly global economy. Even with the repeal of most available exemptions, it is doubtful that the specified options for replacing RLE would be sufficient. Even if the legislature employs other, as yet unspecified options, it is unlikely that a revenue package could be put together that has a high degree of reliability, let alone certainty, that it would raise the required revenue, especially in early years. This puts school funding at risk.

The replacement or reduction of RLE, or restrictions on its growth, should continue to be explored. A longer-term phase-out of RLE is one approach; however, these proposals, which do it all at once, carry considerable risk.

Florida’s economic foundation and its economy for the foreseeable future is facing its strongest challenge in over 50 years. The future is uncertain. Forcing the legislature to make major unspecified changes to the state’s tax structure is a dangerous proposition.

CP 42 - Presumption of Correctness/Burden of Proof in Property Tax Challenges

This proposal is aimed at “leveling the playing field” between taxpayers and property appraisers. Currently, in appraisal challenges, the property appraiser is presumed to be correct. The presumption is lost if the taxpayer can show that the appraiser failed to properly consider all the statutory criteria or that the assessment is based on appraisal practices that differ from those generally used within the same class of property and within the same county. It is only then that the taxpayer can prove the assessment is too high by presenting the preponderance (majority) of the evidence. If the presumption is not lost, the burden of proof for the taxpayer is the much higher “clear and convincing evidence.”

Proponents of changing burden of proof/presumption of correctness say that the odds are stacked against taxpayers and that very few prevail in challenges. Property appraisers say the data on who wins challenges is skewed because cases where the taxpayer does not show up are counted as the appraiser prevailing and that their retention of the presumption of correctness is crucial.

Florida TaxWatch has recommended since 1996 to reduce the burden of proof for taxpayers. It boils down to a simple principle: If the majority of the evidence shows that the appraisal is too high, the taxpayer should get relief.

Florida TaxWatch conclusion. The burden of proof for taxpayers should be the preponderance of the evidence. This issue is probably better addressed statutorily than in the constitution. An amendment to Statutory Recommendation 13 has been filed that is a good approach to the issue. It provides that the appraiser shall have the burden of going forward and proving that his or her assessment was arrived at by complying with s. 193.011, *Florida Statutes*, and professionally accepted appraisal practices, in which case the assessment shall be presumed correct. The taxpayer shall have the burden of proving by a preponderance of the evidence that the assessment is in excess of just value. Florida TaxWatch recommends that the TBRC propose similar statutory language to the Legislature, where there appears to be considerable support. CP 42 should be kept alive as a placeholder for constitutional consideration in case the 2008 legislature fails to act.

CP 06 (combines CPs 06, 08 & 34) – Working Waterfronts

Florida's property tax system has shifted billions of dollars in tax burden from homestead to non-homestead property. The properties that have been hurt the most are those that have seen their assessments rise the most. This is magnified when the property is assessed at its "highest and best use" instead of what the commercial property is currently used for.

CP 06 attempts to address the bigger issue of "highest and best use" for one particular class of property – working waterfronts. Under the proposal, working waterfronts include commercial fishing facilities, marinas, drystacks, boat ramps, and other water-dependent businesses such as boat manufacturers. The proposal requires that these properties be assessed based on current use.

The economic viability of working waterfronts has been hampered as development interests increasingly encroach upon or buy such properties and convert them to residential properties such as high-rise condominiums or high-end retail properties. This increases property values and therefore property taxes, which has put many such businesses at risk. It creates a vicious cycle in which high taxes help drive working waterfronts to convert to their "highest and best use," further reducing the amount of property available for these uses and further increasing property value. This also reduces the public access to waterfronts.

Florida TaxWatch conclusion. The "highest and best use" issue is a complex one. The constitution generally requires property to be assessed at just value. The courts have ruled that just value means fair market value. However, it may not always be in the state's best interest to encourage property to convert to its "highest and best use," especially in the case of property so central to the identity of Florida. Florida TaxWatch finds that this is the best approach to the issue-targeted constitutional exceptions to the just value requirement for special types of property. Working waterfronts deserve to be at, or near, the top of the list.

About Florida TaxWatch

Florida TaxWatch is a statewide, non-profit, non-partisan taxpayer research institute and government watchdog that over its 29-year history has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Its mission is to provide the citizens of Florida and public officials with high quality, independent research and education on government revenues, expenditures, taxation, public policies, and programs, and to increase the productivity and accountability of Florida Government.

Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: in its first two decades alone, policymakers and government employees implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than \$6.2 billion -- approximately \$1,067 in added value for every Florida family, according to an independent assessment by Florida State University.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It is the only statewide organization devoted entirely to Florida taxing and spending issues. Its research and recommendations are reported on regularly by the statewide news media.

Supported by voluntary, tax-deductible memberships and grants, Florida TaxWatch is open to any organization or individual interested in helping to make Florida competitive, healthy and economically prosperous by supporting a credible research effort that promotes constructive taxpayer improvements. Members, through their loyal support, help Florida TaxWatch bring about a more effective, responsive government that is accountable to the citizens it serves.

Florida TaxWatch is supported by all types of taxpayers -- homeowners, small businesses, large corporations, philanthropic foundations, professionals, associations, labor organizations, retirees -- simply stated, the taxpayers of Florida. The officers, Board of Trustees and members of Florida TaxWatch are respected leaders and citizens from across Florida, committed to improving the health and prosperity of Florida.

With your help, Florida TaxWatch will continue its diligence to make certain your tax investments are fair and beneficial to you, the taxpaying customer, who supports Florida's government. Florida TaxWatch is ever present to ensure that taxes are equitable, not excessive, that their public benefits and costs are weighed, and government agencies are more responsive and productive in the use of your hard-earned tax dollars.

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