BRIEFINGS

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The Property Tax Crisis: Legislature Should Focus on Providing Immediate Relief to All Taxpayers

As most everyone in Florida now knows, something must be done about property taxes. The current system is unfair; it has created unaffordable tax obligations for many and has dire ramifications for the state's continued economic health.

On the whole, local government spending, along with property taxes and other revenues, has been rising largely unchecked. Escalating property values have led to extraordinary property tax gains by local governments and higher tax bills for many. The Save Our Homes amendment has kept taxes down for a large number of Floridians, so the growth in property taxes is unfairly being borne by the rest of the taxpayers. This has created a host of other problems, including unequal taxes on similar houses, people feeling they cannot afford to move and an impact on affordable housing by increasing rents and the tax liability on new homes.[1]

The current system is unsustainable and comprehensive change is needed. Florida TaxWatch commends the Governor and the Florida Legislature for committing to address these problems but cautions that in the rush to "do something about property taxes" they avoid attempting fixes that may have popular appeal, but fail to provide long-term solutions and, in fact, worsen some of the current problems.

A number of bills relating to property taxes have been filed this session, reflecting a wide range of proposals. House Republicans were the first to offer a comprehensive leadership proposal, followed by the House Democrats. At this time, the Senate is still developing its plan. Governor Charlie Crist also offered a number of proposals in January.

There may not be time in the remaining session to properly vet comprehensive constitutional property tax reform proposals. A major proposal should not be sent to the voters until there is broad consensus that it is the best approach and all consequences have been identified and examined. **However, the Legislature can, and should, provide immediate and substantial property tax relief for all taxpayers this session.**

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[1] Link to TaxWatch reports on property tax crisis: http://www.floridataxwatch.org/news/propertytax.php.

The House Republican Plan Has Some Very Good Provisions, However Sales Tax Switch is Problematic

This House plan is an ambitious, far-reaching plan to reduce property taxes. It includes a major roll-back of current property tax rates, replacing all property taxes on homestead property with a 2.5% increase in the sales tax and then limiting the ability of local governments to increase millage rates and property tax revenue. It would also tighten the current state revenue limitation, which does not directly affect property taxes. The House plan has two parts, statutory changes to give property tax relief now and a proposed constitutional change, centered on the sales tax /property tax switch.

Statutory Changes

First, the plan proposes an immediate reduction in local millage rates for all jurisdictions except school districts. The average savings in the original plan is expected to be 19%, which would be reflected in taxpayers' next tax bill. To calculate the new rates, local governments would have to go back to their 2000-01 tax rate and then calculate the rolled-back rate for each subsequent year. A "rolled-back rate" is the millage rate that will raise the same amount of revenue on the new tax base that was raised last year. Only growth in revenue from new construction, improvements and annexations is allowed. The rolled-back rate would then be adjusted for inflation. In effect, local governments' new millage rates would only allow for revenue to grow from 2000-01 by new construction and inflation.

School districts and taxes levied to pay bonds would be exempt from this roll-back. Initial estimates show that this would reduce local revenues by:

Counties: 29%   Cities: 38%   Special Districts: 40%

The House Policy and Budget Council, the bill's last stop before the full chamber, reduced the impact of the bill in a number of ways. It exempted children services districts, hospital districts and the state's "fiscally constrained" counties. There are 30 small, rural counties that are designated as "fiscally constrained" in Florida, meaning that one mill would raise less than $5 million. It is expected this would reduce the total savings to from $5.8 billion to $5.5 billion, an average savings of 18% on Floridians' property tax bills.

The revenue cap may be exceeded with a majority-plus-one or two-thirds vote, whichever is greater, of the governing authority such as a county commission. If a local government exceeded the cap without a supermajority vote, it would lose state revenue sharing funds.

Constitutional Changes

The House also proposes a constitutional amendment to replace all property taxes (including those supporting school districts) on homestead property with a 2.5 cent increase in the state sales tax rate, increasing the rate from 6% to 8.5%. This would make Florida's sales tax rate the highest in the nation. With local option sales taxes, the tax rate in some Florida counties would be a high as 10%.

After the statutory rate roll-back, eliminating taxes on homestead property would cost $7.78 billion (based on the original version). The proposal assumes a 2.5% sales tax would raise enough revenue to cover that cost. The increased sales tax would be dedicated to local governments.

Future property taxes on non-homestead property would be limited in the manner described above. School districts, which would not be required to calculate rolled-back rates from 2000-01, would instead limit future growth of property taxes by population and inflation.

A taxing authority could exceed the cap only with a **unanimous** vote of its governing body.

To show "what's good for the goose is good for the gander," the proposed amendment would **also limit state revenues** to the growth of population plus inflation, including retroactive application to 2000-01.

This cap would include state revenues used to match Medicaid. The state revenue limitation may be exceeded in any year by a 2/3 vote of the membership of each legislative house. State revenues collected in excess of the limitation must be deposited in the Budget Stabilization Fund or used for local government tax relief.

This would be a much stricter limitation than the one currently in place, which is based on personal income growth and excludes Medicaid.

Concerns: Is A Sales Tax Swap Good For Florida's Economy?

The House plan is an extremely ambitious effort that has a lot of good elements, some of which Florida TaxWatch has previously recommended. We have recommended a future limit on millage rates and that is essential to any real reform. We have also recommended tightening the state revenue limitation. Perhaps the most attractive part of the House plan is that it effectively eliminates Save Our Homes.

Immediate tax relief is also needed and the statutory millage rate roll-back would certainly provide that. Florida TaxWatch has been the foremost advocate of government "belt tightening." We believe most local governments could absorb significant revenue reductions. However, based on the proposed property tax revenue reductions (Counties 29%, Cities 38% and Special Districts 40%) the House plan may be too ambitious in this area. Governments always predict doom and gloom in the face of budget cuts, but in this case such claims may have merit. Such cuts would be extremely difficult to implement in one fell swoop. There is a provision for a supermajority override of the roll-back, but political pressure to grant the relief would be massive.

The centerpiece of the plan, trading homestead property taxes for increased sales taxes, is the most radical feature of the plan, and in the end, the most problematic. It raises questions of tax equity, stability and administration as well as significant issues of economic competitiveness and the effect on Florida's business climate.

- It is inequitable to exempt one large class of taxpayers from a significant source of government income, while increasing another tax that everyone pays to replace it.
- It would be a significant tax increase on people that do not own homestead property.
- It would replace a proportional tax with one that is more regressive.
- It would increase taxes for business, which have already been bearing the brunt of massive property tax increases. It will cut the cost at one end, for homesteaded homeowners, but this tax shift will add tremendous costs to business inputs, increase the cost of doing business in Florida, and make the state far less economically competitive with our neighboring states.
- Florida would have the highest state sales tax rate (8.5%) in the nation and the total rate would be as high as 10% in some counties. This would:
    - Make Florida retailers less economically competitive with other states,
    - Make Florida more expensive (and less desirable) for tourists,
    - Hasten the eroding of Florida's sales tax collections from internet and other remote sales, and
    - Create some major enforcement issues. With sales taxes that high, people will search for ways to avoid them.
- The increased sales tax rate would have an impact on current state sales tax collections. Increasing the state rate to 8.5% will likely result in a reduction in the revenue produced by the current 6% tax rate.
- How would the sales taxes be distributed back to the local government? If all local governments were held harmless (get the same dollar amount or the same proportion of total sales tax that jurisdiction got from property taxes), some local areas would be subsidizing the cost of local government in other areas. Any other method would be a major political battle and would create winners and losers.
- It could have an impact on local governments' bond ratings. By replacing a large source of revenue that may be increased locally with one that locals have no ability to increase, a government's tax capacity would be reduced. Bond rating agencies consider tax capacity a major factor in a credit rating. A lowered rating increases the cost of long term debt, which is most often used to finance local infrastructure such as roads, bridges, and jails.

- It would reduce local flexibility. While local governments have the ability to adjust millage rates, they would have no ability to change the state sales tax rate.

- Without a limit on overall local revenues, the plan will surely result in increases in other local taxes and fees, including special assessments, impact fees and charges for services.

The House Plan would remove a key check on Local Government spending

A major concern is that by eliminating property taxes for homesteaded homeowners, Florida would be taking these voters almost entirely out of the local budgeting and spending process, which is not healthy for a representative democracy. Local governments do not have all the checks and balances that are present at the state level. Decisions are made by a relatively small number of officials with no other body (such as the other legislative chamber or a governor) to say no. Citizen involvement is critical and homeowners tend to be the ones local politicians listen to.

Save Our Homes led to a big reduction in this type of taxpayer oversight, and likely contributed to the increased local spending over the last few years. Citizen input began to increase again last year, as the problems created by Save Our Homes began creating big tax bills for some homeowners. As homeowners would no longer have to bear the cost consequences of demands for increased local services, eliminating property taxes entirely on resident homeowners would almost completely remove homeowners from their local governments' tax and budget processes, eliminating a key check on government spending. It is certain that those same citizens, however, will continue to press government for more services, leading to further imbalance in the system.

The Governor's Property Tax Recommendations

In January, Governor Charlie Crist announced his recommendations to address Florida's property tax crisis. The Governor proposed:

1) Doubling the homestead exemption from $25,000 to $50,000 and then annually adjusting it for inflation. If statewide voters approve a constitutional amendment to do this, each county would have to hold a mandatory, separate referendum to approve the increased exemption in their county.

2) Allowing statewide portability of Save Our Homes assessment differential. This would allow homeowners to take their reduced assessment with them when they move.

3) Expanding the Save Our Homes 3% assessment growth limit to cover all property (homestead and non-homestead).

4) Businesses with less than $25,000 in tangible personal property (computers, equipment, office furniture, etc.) would be exempt from paying taxes on that property. It is estimated that this would exempt one million small businesses (worth $200 million at current millage rates.)

The Governor also recommended a special election in 2007, so that voters can consider the constitutional amendments needed to implement these recommendations.

Concerns: Increase In The Homestead Exemption And Portability Could Increase The Tax Shift

The Governor's recommendations would improve the current system, but there are concerns. Florida TaxWatch has cautioned against increasing the homestead exemption and allowing portability without addressing non-homestead taxes because those steps would further exacerbate the tax shift. While it would help first-time home buyers and people that move, increasing the homestead exemption would provide substantial relief to many whose taxes have not increased, while further burdening those that have borne the brunt of the increases. Without comprehensive changes, the Legislature should avoid the politically expedient move of proposing an increased homestead exemption.

Expanding the Save Our Homes cap to all property would help by reducing the future tax shift. However, the current disparity between homestead and non-homestead taxes would remain, and grow larger from the (annually) increased homestead exemption.

Additionally, many of the problems created by Save Our Homes within homestead property would pop-up among non-homestead property. Ultimately, the majority of the burden for increasing property taxes would be borne by new construction (both homes and commercial property).

Also, by limiting the increase in assessments (value) for all property, there would be no effective limit on taxes for anyone. Save Our Homes did little to limit total taxes, but homesteads saved by shifting the burden to non-homestead property (and new homes and people who move). With no one to shift it to (except new construction) and if local governments increased millage rates to offset reduced assessments, the tax increase would be borne by everyone.

Florida TaxWatch commends Governor Crist for being balanced with his property tax reform proposals by addressing the taxes paid by all property owners. But care has to be taken that the same problems created by Save Our Homes for homestead property do not occur for non-homestead property, and that the burden for increasing property taxes is not unduly borne by new homes and new commercial property. It must also be remembered that true reform must include responsible ways to hold down local government spending and millage rates to provide long-term fiscal stewardship.

The House Democratic Plan

The Democrats recently rolled out a plan that would impose a one-cent sales tax to provide increased exemptions to all property. Homestead properties would get an exemption equal to one-half of the median value of single-family homes in the county, if their total exemption exceeds their Save Our Homes value. The current $25,000 homestead exemption would be applied first, the next $25,000 of value would be taxed and then the new exemption would kick in. Non-homestead residential property would get a similar exemption and counties could provide relief to renters. Commercial property would get an exemption equal to 25% of its value, with the exemption being capped at $250,000. These exemptions would be worth $3.7 billion at current rates. The plan also would limit future property tax increases to a higher rate than the Republican plan, adding another 3% to allowances for new construction and inflation.

The Democratic plan is certainly worthy of serious examination as it is a creative attempt to provide relief for all taxpayers. However, increasing the sales tax raises some of the same concerns that the Republican plan does (to a smaller degree because of the lower rate). Also, using the sales tax to replace only a portion of the property tax is problematic. Since millage rates are adjusted every year, it is difficult to assure that the added sales tax revenue continues to be reflected in lower property tax rates. Moreover, by reducing everybody's taxable value, more upward pressure is put on millage rates. This is why a revenue limit is essential in this scenario, and the one proposed by the House may not be low enough.

And while the proposal should help with some of the existing inequities among homestead properties, there will be more shifting of tax burden to some non-homestead properties, magnifying what has already happened under Save Our Homes. For example, 42% of the relief goes to homestead property, which comprises only 32% of the total taxable value in the state. And since Save Our Homes would still exist, that tax shift would continue to grow.

The Senate Plan

The Senate leadership has also yet to unveil its entire plan, but has begun to debate its first proposal. This would require property to be assessed on its current use, instead of the present "highest and best" use standard. The mandate to assess all property at fair market value, or "highest and best use," means that commercial property is taxed on what the property can sell for, not what the value of it is with the existing business. This has created unaffordable tax liabilities for many businesses, such as small hotels and apartments, and small businesses near the waterfront. However, care must be taken to limit abuses of a current use standard. This may require a constitutional fix and may be best achieved by creating classified use exemptions, similar to the current one for agricultural land, for specific types of property.

The Senate is also considering some of the Governor's proposals, including allowing portability of Save Our Homes and providing a $25,000 exemption for tangible personal property taxes. It is also looking at a tax roll-back, but it will probably not go back as far as the House plan. Senate leaders have indicated that a final proposal may not surface for another three weeks or more.

Florida TaxWatch Recommendations: Tax Relief First, Then Comprehensive Reform

Florida TaxWatch recommends that the 2007 Legislature work to provide smart, meaningful and equitable property tax **relief** during this session. However, the Legislature should not attempt major **reform** of the property tax system through proposed constitutional amendment this session, especially by calling a special election in 2007.

This approach would give immediate relief through property tax reductions for all taxpayers and allow the Taxation and Budget Reform Commission to continue the debate on property tax reform and fully deliberate and examine the options, with an eye toward comprehensive, non-political solutions.

To achieve the first step , property tax relief, Florida TaxWatch recommends that the Legislature should require all cities, counties and special districts to roll-back their taxes, similar to what the House proposed, but on a smaller scale. Instead of going all the way back to 2001 (and adjusting forward), the Legislature should require local governments to reduce their rolled-back rates for next year by 10%. This would give taxpayers a real tax cut of approximately $1.8 billion. To reward local governments that have shown fiscal responsibility, the required reduction could be the lesser of 10% or a two-year roll-back of rates (adjusted forward as in the House plan).

Secondly, the Legislature should find as much state revenue as possible to buy down the Required Local Effort (RLE). RLE is the millage rate the state requires school districts to levy in order to participate in Florida's school funding program. The increase in the amount of RLE mandated by the Legislature has been a significant part of Floridians' increasing property tax burden and therefore the state should contribute to relief. Reducing this burden provides equitable relief to all taxpayers.

In order to maintain school funding, the state would have to make up the reduced RLE revenue. This is shaping up to be a tough budget year. But this needs to be done even if the Legislature has to use non-recurring general revenue. The state will be asking local government to tighten their belts to provide property tax relief so the state should do the same and provide a minimum $1 billion RLE reduction. Every $1 billion in reduced RLE is $1 billion of direct property tax relief, giving taxpayers an average 8.1% reduction in their total school property taxes (a 13.5% reduction in RLE taxes).

Thirdly, the Legislature should propose a $25,000 exemption for tangible personal property. This is one constitutional proposal that could be offered now, as there is a broad consensus on it. Florida TaxWatch has long been a proponent of exempting small business from tangible personal property taxes and we commend the Governor for recommending this. Businesses have borne the brunt of Florida's property tax increases. This will help small businesses cope with the large property tax increases they have experienced. Also, complying with the law creates a lot of work for both the public and private sector with (in the case of small businesses) relatively little return.

Other statutory improvements that can be achieved this session include enhancements to the Value Adjustment Board process and the Truth-in-Millage notices.

With the Legislature providing property tax relief this year, the Taxation and Budget Reform Commission (TBRC) can turn its attention to reforming the system and Save Our Homes. The TBRC held its first meeting last week and it has the ability to take proposed constitutional amendments directly to the voters.

Florida TaxWatch reiterates to the TBRC our proposal for comprehensive property tax reform, which was first laid out in our December 2006 report *Controlling Escalating Property Taxation and Local Government Spending and Revenue*[2]:

- Repeal the Save Our Homes Amendment, but allow homeowners to keep their current reduced assessment, so their savings will be retained. The amount of the differential would not change. For example, if a home were assessed at $60,000 below fair market through Save Our Homes, future assessments would be at full market value minus $60,000.

- Limit annual millage rates by requiring that local governments adopted a re-defined rolled-back rate (one that allows for inflation). This would provide a direct property tax limitation for all property owners in Florida. It could be overridden by a supermajority vote of the jurisdictions governing body.

- Institute a cap on the growth of all local government revenue, limiting it to either the growth of population and inflation or personal income. This could also be overridden by a supermajority vote.

- We also recommended a one-time, statewide portability of a homeowner's assessment reduction, but serious constitutional issues with portability have been raised.

- Base the assessment of certain commercial property on current use. The mandate to assess all property at fair market value, or "highest and best use," means that commercial property is taxed on what the property can sell for, not what the value of it is with the existing business. This has created unaffordable tax liabilities for many businesses, such as small hotels and apartments, and small businesses near the waterfront. However, care must be taken to limit abuses of a current use standard. This may be best achieved by creating classified use exemptions, similar to the current one for agricultural land, for specific types of property.

These recommendations would create a system that protects taxpayers' current savings, keeps inequities from getting worse and begins to equalize them, and most importantly, holds taxes down for all property owners in the future. The need for revenue limitations is gaining wider and wider acknowledgment. Both parties in the House have included limits in their plans. Local

[2] Link to Florida TaxWatch report: http://www.floridataxwatch.org/resources/pdf/LocalTaxationReportFINAL.pdf.

governments are beginning to consider creating limits themselves.[3] Meaningful, but workable, limits can help avoid more draconian limits being imposed on local governments by angry taxpayers.

The 2007 Legislature should work to provide immediate, fair property tax relief. If truly reforming the system takes time, we should take it. The Taxation and Budget Reform Commission is positioned to fully evaluate all plans and offer voters a package that is fair to all Florida taxpayers, helps keep future tax increases in check and creates a system that is good for Florida's competitiveness and economic vitality.

**This *Briefings* was written by Kurt Wenner, Senior Research Analyst,
under the direction of John Turcotte, Senior Vice President for Research.**

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initially released before being printed in hardcopy format.

[3] Florida TaxWatch commends the Hillsborough County Commission for taking the first steps at true budget reform, by its action on February 7, 2007 to limit the increase in the county's annual spending to the rate of inflation plus the county's population growth.

About Florida TaxWatch

Florida TaxWatch is a statewide, non-profit, non-partisan taxpayer research institute and government watchdog that over its 28-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.

The Florida TaxWatch Board of Trustees is responsible for the general direction and oversight of the research institute and safeguarding the independence of the organization's work. In his capacity as chief executive officer, the president is responsible for formulating and coordinating policies, projects, publications, and selecting professional staff. As an independent research institute and taxpayer watchdog, Florida TaxWatch does not accept money from Florida state and local governments. The research findings and recommendations of Florida TaxWatch do not necessarily reflect the view of its members, staff, distinguished Board of Trustees, or Executive Committee, and are not influenced by the positions of the individuals or organizations who directly or indirectly support the research.

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