

NEW YORK PROPERTY TAXES

Like most states, New York relies on local property taxes as its primary funding source for public education. Property taxes are a slow-growing source of revenue—a troubling feature for a revenue stream designed to fund growing educational costs. Even more troubling, the property tax is profoundly unfair, imposing higher burdens on lower- and middle-income taxpayers and placing less wealthy school districts at a competitive disadvantage in funding education. The challenge facing state lawmakers is to find a way to adequately fund education that mitigates these twin sources of unfairness, reducing the burden on low-income New Yorkers and mitigating the gap between low-property-wealth and high-wealth taxing districts. This chapter looks at the impact of New York property taxes on tax fairness and school funding, and evaluates options for property tax reform.

New York Property Taxes: How High?

New York property taxes are higher than in most other states. In fiscal year 2002, New York property taxes as a share of income were almost 25 percent above the national average—10th highest nationally. However, the state’s property taxes have fallen compared to other states in the past twenty five years: as recently as 1980, New York property taxes were more than fifty percent above the national average.

	% of		% of Total	
	<u>Pers. Inc.</u>	<u>Rank</u>	<u>Taxes</u>	<u>Rank</u>
Connecticut	4.1%	7	39.6%	9
Massachusetts	3.5%	17	36.5%	12
New Jersey	4.8%	3	46.3%	2
New York	3.9%	10	30.2%	25
Ohio	3.2%	22	29.4%	29
Pennsylvania	2.9%	29	29.0%	31
Vermont	4.6%	4	41.9%	4
ALL STATES	3.2%		30.9%	
Addendum: New York as a % of National Average				
	124%		98%	

SOURCE: Bureau of Economic Analysis, Bureau of the Census

Property Taxes are Regressive

New York property taxes are regressive: lower-income taxpayers pay more, as a share of income, than do financially better-off taxpayers. The poorest twenty percent of New Yorkers pay 4.4 percent of their incomes, on average, in property taxes. Middle-income taxpayers pay 3.5 percent of their income in these taxes, and the wealthiest one percent of New Yorkers pay 1.6 percent of their incomes in property taxes.

The main reason why property taxes are regressive is that they are based on home values rather than on income levels. Home values represent a much higher share of income for middle- and lower-income families than for the wealthy. For example, it is common for a middle-income family to own a home valued at two or three times their annual income, but wealthier taxpayers are less likely to own homes worth as much relative to their income levels. As a result, property taxes generally take a larger share of income from middle-income families than from the better-off. And property taxes are insensitive to variations in taxpayers’ income: a taxpayer who suddenly becomes unemployed will find that her property tax bill is unchanged, even though her ability to pay it has fallen. By contrast, income taxes vary with income, so income taxes are more sensitive to taxpayers’ ability to pay.

While the public’s attention to property taxes is usually focused on the taxes paid by homeowners, the property tax also affects taxpayers who rent, rather than own, their home. It is generally assumed that some of the property taxes falling initially on owners of rental real estate are passed through to renters in the form of higher rents. Notably, New York’s largest form of property tax relief, the STAR homestead exemption, only provides relief to homeowners. Because renters tend to be poorer than homeowners, this makes the tax system more regressive.

Property taxes are also paid by businesses. Some of the business property taxes paid in New York are passed through to out-of-state shareholders and owners. Without this business tax, many businesses that use state services would go largely untaxed.

Homeowner property taxes can be partially offset by federal income tax deductions for those itemizing their federal returns. Overall, about 15 percent of these taxes are offset by federal tax cuts in this way.

How Property Taxes Work

Property taxes are among the most venerable revenue sources used by states. As originally designed, these taxes usually applied to all forms of property wealth, including:

- Real property (land and buildings)
- Personal property (cars, furniture, and other moveable, tangible items)
- Intangible property (paper assets such as stocks and bonds)

In recent decades, most states have moved away from taxing personal and intangible property and now tax only real property. New York taxes some business personal property, but individual New Yorkers generally pay property tax only on their homes.

The amount of property tax paid on any particular home is usually calculated through a multiple-step process. First, county officials assess the taxable value of each property by estimating the amount for which it could be sold—its *market value*. This can be done by direct observation of each individual home, or by observing a smaller sample of homes and using the sample to estimate the value of other similar homes. Second, property is valued for tax purposes—its *assessed value*. The third step is determining the *taxable value* of the property, by subtracting any exempt value from the home. Finally, a millage rate is applied to the property's taxable value. The formula for a given taxing district's millage rate is:

$$(\text{Tax Levy}/\text{Taxable Value}) \times 1000$$

The tax levy represents the amount of revenue being raised. While this procedure works the same way in every New York school district, the rates of at which property is taxed vary widely between districts. In 2001-2002 school year, the median tax rate was 2.3 percent; ranging from 0.38 percent in the East Hampton School District to 2.63 percent in the Levittown School District.

Property Tax Limits

Since California introduced its "Proposition 13" property tax limits in the late 1970s, almost all states have introduced some form of property tax limit. New York law imposes limits on the overall tax rate that some levels of government can impose on properties. Counties can levy up to 1.5 percent of value, most cities can levy up to 2 percent of value, and New York City can levy up to 2.5 percent (each of

these limits are calculated by taking the tax as a percentage of a five-year average of taxable value)

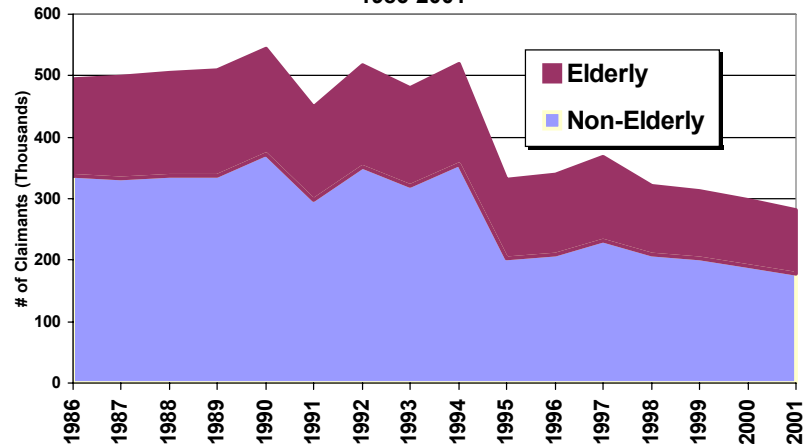
Another common form of property tax limit restricts the annual growth of assessments for any given property. While New York has no statewide limit on assessment growth, New York City and Nassau County each impose this type of limit.

Property Tax Relief

New York property taxes are high and regressive; any effort to alter the state's use of these taxes for funding public education must address low- and middle-income household property tax relief. This section discusses New York's property tax relief mechanisms.

New York has three state-financed property tax relief mechanisms: a refundable circuit breaker for low-income households and renters, a refundable school property tax credit for farmers, and the School

New Yorkers Claiming the Property Tax "Circuit Breaker"
1986-2001



Tax Relief (STAR) property tax exemption program.

Since 1978, New York has provided low-income homeowners and renters with a refundable tax credit designed to offset especially high property tax burdens. New York's "circuit breaker" credit is available to homeowners and renters earning less than \$18,000. For homeowners whose property taxes exceed a threshold ranging from 3.5 percent of income to 6.5 percent of income, the circuit breaker credit equals half of the amount by which property taxes exceed this threshold. The credit is capped at \$375 for elderly taxpayers and \$75 for those under 65. The credit is limited to homeowners with home values under \$85,000 and renters with average monthly rent of \$450 or less.

When the circuit breaker was last expanded in 1986, it was among the more generous state property tax relief mechanisms in the nation. But the credit has been left unchanged since then, and as a result the real value of the credit has fallen and the number of state taxpayers claiming the credit has decreased each year. In 1986, almost 500,000 New Yorkers claimed the circuit breaker credit. By 2001, that number had fallen by almost half, to 282,000. This decline is largely attributable to the failure of policymakers to preserve the real value of the credit.

If the main features of this low-income circuit breaker had been adjusted for inflation since 1986, the income threshold would be \$30,521 in 2004; the home value limit would be \$144,128; the average monthly rent would be \$763 and the maximum amount refunded to taxpayers over 65 would be \$636 and \$127 for everyone else.

In general, circuit breakers are an effective means of providing property tax relief. First, circuit breakers address the “insensitivity problem” of property taxes. As already noted, property taxes are insensitive to yearly fluctuations in a taxpayer’s ability to pay, since they are based on property value, not on income. But since circuit breakers allocate their benefits according to the relationship between taxes and income, their benefits are targeted precisely to low-income taxpayers. Second, the better targeting of these credits means that they cost less than “across the board” property tax relief measures—such as homestead exemptions. Third, a substantial portion of “across the board” property tax relief is never received by state residents at all, but is immediately offset by increased federal income taxes for itemizers.

New York also provides a credit against school property taxes to farmers. To be eligible, two-thirds of a taxpayer’s income must come from farming. The credit refunds 100 percent of school property taxes paid on up to 250 acres of agricultural property, and 50 percent of the taxes paid on acreage in excess of 250. The full credit is available to taxpayers with incomes under \$100,000. The credit is gradually phased out for taxpayers with incomes between \$100,000 and \$150,000.

The most expensive form of state-financed property tax relief is the STAR homestead exemption. Enacted in 1997 and phased in over four years, STAR exempts a certain amount of home value from local school property taxable value. Local governments are then reimbursed by the state for the amount the exempted value would have raised for local school districts. Under STAR, all owner-occupied residential

dwelling are eligible for a state-funded “homestead exemption” of at least \$30,000. In counties in which the median home value is greater than the statewide median home value, the value of this exemption is increased. This means that homeowners living in wealthier counties receive bigger homestead exemptions. As a result, a wealthy homeowner living in Westchester County will receive a STAR exemption of \$82,500 while a poor homeowner in a low-wealth county will receive only the basic \$30,000 exemption.

Elderly homeowners with incomes under \$60,000 (adjusted upward to keep pace with inflation after 2002) are eligible for an *enhanced* STAR exemption of \$50,000. Like the basic exemption, the enhanced exemption is increased in counties with home values above the statewide median. In Westchester, the enhanced exemption is currently \$137,590.

In the 2001-2002 school year, STAR exemptions accounted for \$1.875 billion in foregone property tax revenues for school districts outside New York City—slightly more than 15 percent of the \$12.394 billion in property tax revenues actually collected by those districts. New York City received \$112 million in STAR reimbursements—just 2.1 percent of the city property tax revenues allocated to the New York City school system. In recognition of the limited benefits that would accrue to New York City under the STAR property tax exemption, the initial STAR legislation established a special New York City STAR supplement which provides for a state-funded reduction in the New York City resident income tax. This element of the program provided New York City residents with \$520 million in income tax relief in 2001-2002.

STAR has been the centerpiece of legislative efforts to reduce property taxes in recent years. But STAR has significant faults:

- Like most homestead exemptions, STAR is poorly targeted in that it is provided to homeowners at all income levels; the exemption reduces the tax on the wealthiest estate and the smallest row house.
- The STAR exemption goes only to homeowners, even though renters pay property taxes indirectly in the form of higher rents—another flaw shared with other states’ homestead exemptions.
- Unlike the homestead exemptions used by most other states, STAR targets more generous exemptions to taxpayers who live in wealthier counties. As a result, two homeowners with the same income and the same home value can receive dramatically different exemptions simply because they live in different counties.

- The generosity of the STAR exemption to wealthier homeowners means that a substantial portion of the STAR tax relief is offset in the form of higher federal income taxes for New York itemizers.
- The \$60,000 income threshold for the elderly “enhanced” exemption creates a “cliff” effect. Elderly taxpayers with income of slightly less than \$60,000 get benefits that are two-thirds more than taxpayers with only slightly higher incomes.
- In addition, there is no other mechanism for relating elderly homeowners’ property taxes to their income: all elderly homeowners with incomes under \$60,000 receive the same exemption, even if one has income of \$10,000 and the other has income of \$50,000. In other words, the elderly enhanced exemption has very little sensitivity to homeowners’ ability to pay the tax.

Issues in Assessing Property

One unique problem facing the property tax is that, by comparison to the sales and income tax, the property tax base can be difficult to measure accurately. In theory, the tax base should be equal to the market value of all real estate. But market value changes on an almost daily basis, and even a perfectly informed assessor would find it difficult to update home values in a timely fashion.

In most states, the quality of assessment has historically been poor—and New York is no exception. In 1975, the Court of Appeals ruled that all properties must be assessed at their true market value. After a contentious debate, in 1981 the state legislature authorized assessment at a uniform percentage of market value—but also authorized New York City and Nassau County to assess each of four different classes

of property at different percentages of market value. As a result of this system, one-, two-, and three-family homes in New York City and Nassau County are assessed today at a much lower percentage of market value than are business properties. This approach to property taxation is known as a “split roll”—the tax base is split into a lower-taxed group (usually residential) and a higher-taxed group (usually business). As a result, the tax burden in New York City and Nassau County has shifted away from residential properties and toward business properties.

Other local governments are not authorized to assess various classes of property at different percentages of full value, but local taxing jurisdictions outside of New York City and Nassau County can adopt separate homestead and non-homestead tax rates as a way of providing tax relief for owners of residential properties. Only a small number of school districts currently practice this option.

This approach to property tax relief is usually defended as a means of reducing onerous tax burdens on homeowners. And it achieves this purpose—but at a large cost. Like a homestead exemption, a split roll is poorly targeted, allowing tax cuts to the wealthiest homeowners. But because the split roll gives all homeowners the same percentage tax cut, it is much less progressive than a targeted property tax cut like the circuit breaker.

Conclusion

Property taxes are inequitable in two important ways. First, these taxes hit low- and middle-income taxpayers most heavily. Second, the gap between low-wealth and high-wealth school districts allows wealthier districts to collect more tax revenue for schools at a lower tax rate—and poor districts must levy a higher tax rate to raise the same amount of money for schools.

New York lawmakers have taken steps to address each of these problems—but the state’s property tax relief mechanisms leave much to be desired. The STAR homestead exemption is expensive and poorly targeted, giving tax cuts to the wealthiest homeowners and no tax relief at all to low-income renters. Meanwhile, the state’s main targeted property tax credit, the “circuit breaker,” has been allowed to lose its value in recent years. Tax relief could be better targeted to those that need it the most by reforming (or repealing) STAR and expanding the circuit breaker.

Comparing the Cost of Three Property Tax Relief Mechanisms

