DC Fiscal Policy Institute

An Affiliate of the
Center on Budget and Policy Priorities
820 First Street NE, Suite 460
Washington, DC 20002
(202) 408-1080 Fax (202) 408-8173
www.dcfpi.org

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WIDENING THE GAP: NEW LEGISLATION WOULD FURTHER SKEW DC'S PROPERTY TAX BENEFITS TO HIGH VALUE HOMEOWNERS AND CREATES TREMENDOUS DISPARITIES IN DC'S PROPERTY TAX SYSTEM

By Jenny Reed and Wes Rivers

Legislation before the DC Council would reduce DC's property taxes for homeowners in two ways, but for several reasons, these should not be the priorities for providing property tax assistance to DC households. The legislation would lower the property tax assessment cap — which limits the yearly growth in a homeowner's taxable assessments — from its current 10 percent limit to 5 percent. The proposal also would eliminate the requirement that every home be taxed at least at 40 percent of its value, regardless of deductions or caps.

This legislation raises two major concerns:

- The proposal would disproportionately benefit owners of higher-value homes and lead to tremendous disparities in DC's tax system. For example, homes worth more than $550,000 represent 31 percent of DC homes but would get 65 percent of the benefits of lowering the annual tax cap to 5 percent.

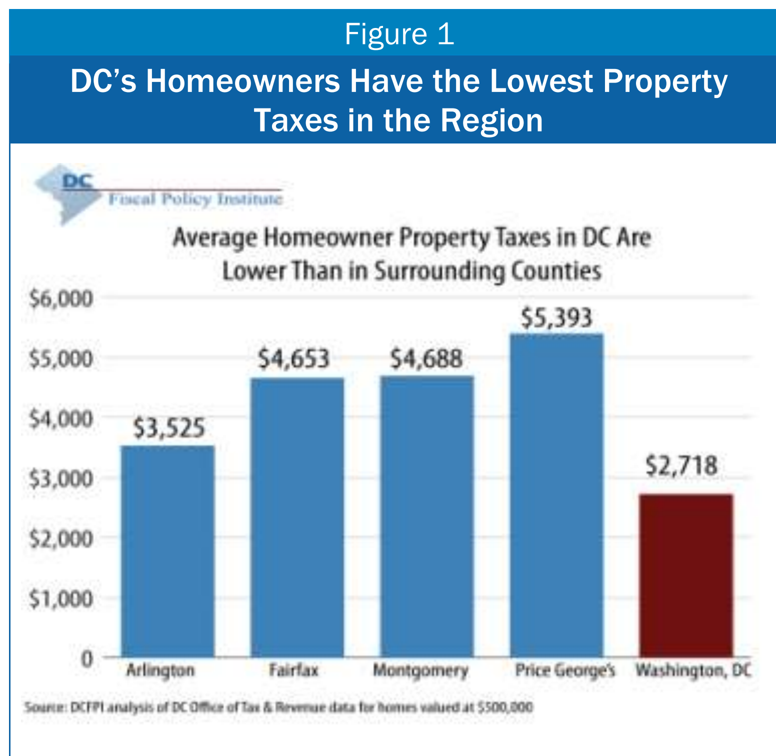
- The proposal would result in great variations in tax bills for homes with the same value. DC's assessment floor ensures that all homeowners pay a minimum, currently 40 percent, of their total assessed value in property taxes. Without it, homeowners living in homes of similar values could end up paying widely different property tax bills.

- The proposal would only provide property tax assistance to homeowners, despite the fact that most DC households are renters — and pay property tax through their rent — and that DC's homeowner property taxes are already the lowest in the region. The District of Columbia's low homeowner property taxes result from having the lowest property tax rate in the region and from other property tax relief mechanisms that limit DC homeowners' property tax bills. Given this, and the fact that most DC households are renters, further reducing taxes for homeowners should not be prioritized.

A better approach to reducing property taxes is reflected in legislation, recently passed on first reading by the DC Council, which makes improvements to a tax credit known as Schedule H.[1] That

[1] B19-164, the "Schedule H Relief Property Tax Act of 2011" passed on first reading on 12-4-12. It was have a second reading on 12-18-12 and if passed, would become law. However, since the bill has a fiscal impact and the Council did not identify funds to pay for the cost of the legislation, it cannot be implemented until funds are identified.

credit is targeted on DC households facing the biggest challenges paying property tax bills and helps both homeowners and renters, but it has not been updated for more than three decades.



DC Homeowners Pay the Lowest Property Taxes on Average in the Region

The typical homeowner with a $500,000 home in DC paid $2,718 in property taxes in 2011, which is the lowest amount in the Washington area.[2] The tax bill for a similarly valued home in Arlington County — the next lowest in the region — averaged $3,525, and the highest property taxes for homes at this value were in Prince George's County with an average tax bill of $5,393. **Figure 1** compares the average property tax bills in DC and the surrounding counties in 2011.

DC's property tax bills are lower in part due to the fact that DC's property tax rate — 85 cents per $100 of assessed value – is the lowest in the region. DC's low-tax status also reflects property tax relief mechanisms that are more substantial than those offered in suburban jurisdictions. The DC Homestead Deduction reduces homeowners' taxable assessment by $69,350 and starting in fiscal year 2013 is indexed for inflation, meaning that the size of the deduction will rise each year. The property tax assessment cap limits the growth in a homeowner's taxable assessment to 10 percent a year which means if property values experience growth rates that exceed the cap, the taxable assessment will only grow at 10 percent a year. These two provisions mean that all homeowners pay less than their full assessment in property taxes.

In 2011, the typical DC homeowners paid tax on only 73 percent of their home's full assessed value due to the assessment cap and Homestead Deduction. This is true even though taxable assessments have been catching up with full assessed values in recent years for the large majority of DC homeowners. During times of stagnant or declining home values, a home with a taxable assessment that is significantly below its assessed value will see their taxable assessments grow by 10 percent to catch up closer to the home's full assessed value. Because market values for many DC homes have been falling or stagnant for several years, as a result of the downturn, taxable assessments have been catching up with full assessments for many homeowners, The fact that the typical DC home still is taxed well below its full value suggests that the current 10 percent cap is effective in limiting increases in taxable assessments.

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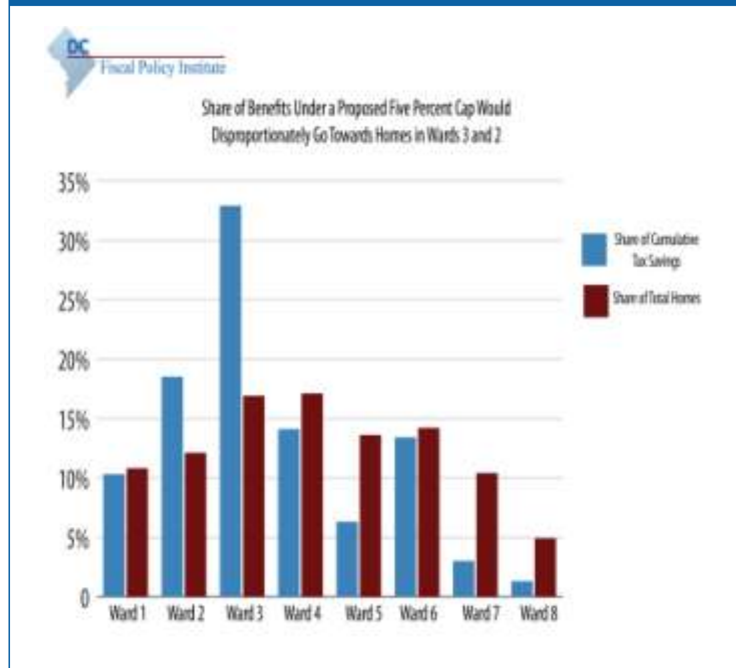
[2] Property sales records from DC and the four surrounding counties were used to select samples of 50 homes with average sales prices of $500,000. In each sample, the tax bills were averaged to get a typical property tax estimate.

Proposed Legislation Creates Several Problems for DC's Property Tax System

Bill 19-1007, the "Residential Property Tax Relief Act of 2012," would make two changes to DC's property tax system: it would reduce the property tax assessment cap from 10 percent to 5 percent and get rid of DC's 40 percent assessment floor. This would create several problems for DC's property tax system by concentrating benefits among higher-value homeowners, creating tremendous disparities in DC's property tax system and weakening the ability of the property tax to support DC's ongoing costs of public services.

Figure 2

The Share of Property Tax Benefits under the Proposed Legislation Would Disproportionately Go to Homeowners in Wards 2 and 3



The Proposed 5 Percent Cap Would Disproportionately Benefit Owners of Higher-Value Homes

- **Tax savings from the bill would be largely for higher-value homes.** Under the proposed legislation, higher-value homeowners would save $292 on their property taxes in 2014 while homeowners with homes assessed at $275,000 or less would save, on average, just $42. By 2023, the savings would total $6,059 for owners of higher-value homes and just $866 for owners of lower-value homes[3].

- **High-value homes would get a disproportionate share of the tax benefits.** High value homes make up just 31 percent of all DC homes, yet under the proposed legislation, these homeowners would receive 64 percent of the total tax savings. Lower value homes would only receive 8 percent of tax savings generated by the bill, even though they represent roughly the same proportion of DC properties as their higher value counterparts.

- **The tax savings from the bill are also disproportionately distributed to Wards 2 and 3.** Wards 2 and 3 constitute 29 percent of the homes in the District, yet they will receive about 52 percent of the total tax savings in 2014 and subsequent years (see figure 2). Combined, Wards 7 and 8 would only receive about 4 percent of the total tax savings, mostly due to lower homeownership rates and lower average home values. (See **Figure 2**.)

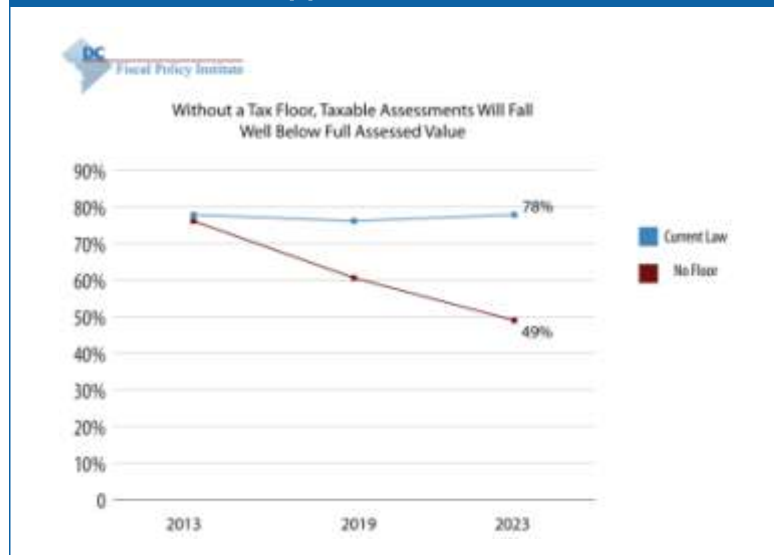
[3] This analysis assumes a 9 percent growth per year in home market values.

The Proposed Legislation Would Create Tremendous Disparities in DC's Tax System

The proposed legislation would also create huge disparities in taxes paid by homeowners by removing the property tax assessment floor. The assessment floor requires homeowners to pay tax on a minimum of 40 percent of their home's total value. It was created because many homeowners were paying taxes on well below 40 percent of their total assessed value — due the homestead deduction and property tax assessment cap — while new homeowners were paying taxes on close to 100 percent of total assessed value of their homes. The assessment floor helps to limit the disparity between two homeowners with similarly valued homes. If the proposed legislation were to take effect, about a quarter of District homeowners will pay less than 40 percent of their home's assessed value by 2023.

Figure 3

Removing DC's Assessment Floor Would Significantly Weaken the Ability of DC's Property Tax to Support Basic DC Services



Removing the assessment floor also would decrease the strength of the property tax base and weaken its ability to support ongoing services. If the floor is repealed and the assessment growth cap is cut to 5 percent, the average homeowner's taxable assessment as a proportion of assessed value would fall significantly over time. For example, the typical DC homeowner would pay tax on just 50 percent of their assessed value in 2023, compared to the 78 percent the typical homeowner now pays under the current law (see **Figure 3**).[4] This would significantly weaken the ability of the revenue generated from the property tax to support the ongoing costs of providing basic District services — like police, fire, trash pick-up and cash assistance for families with children — which rise each year due to inflation or change in need.

Improvements to Schedule H Could Better Target Property Tax Relief To Those Who Need Help the Most

A better approach to property tax assistance in the District is to improve the city's tax credit for lower-income households, commonly referred to as Schedule H. Legislation approved on first reading by the DC Council makes improvements to Schedule H to improve its effectiveness and would help target tax assistance on the DC households — both homeowner and renter — facing the greatest challenges paying their property taxes.

[4] This analysis assumes a 9 percent growth per year in home market values.

DC's Schedule H program is a refundable tax credit that residents can claim when the file their DC income tax. Schedule H is often referred to as a circuit breaker program because it kicks in once a DC resident's property taxes become too large a share of their income. It serves renters as well as homeowners, under the assumption that a tenant's rent includes property taxes passed on by the landlord.

Until recently, many elements of Schedule H have not been updated since the late 1970s and there are several components of the program that limit low- and moderate-income residents' ability to participate.

- **Schedule H has a low income eligibility limit**. Families can claim this credit only if their household income is under $20,000. This income limit has not been adjusted since the 1970s.

- **Schedule H has a low benefit.** The maximum credit under Schedule H is $750 and also has not been adjusted since the 1970s.

- **Restrictive rules make it hard for families to claim this tax benefit.** For example, unrelated individuals sharing housing are required to report their income together, even if they do not file tax returns together.

Recently, the DC Council passed, on first reading, the "Schedule H Property Tax Relief Act of 2011" (Bill 19-0164). This bill makes several improvements to the program to expand its effectiveness and reach. The bill raises the income eligibility limit to $50,000, raises the maximum credit amount to $1,000, and eliminates many restrictive eligibility rules. Unfortunately, the bill has costs and funds were not identified to pay for them at the time the bill passed. This means that the improvements cannot be implemented until funds are identified. The DC Council should focus its efforts to identify funds to provide property tax relief through improvements passed for Schedule H so that the benefits are provided to those households — both homeowner and renter — who have the hardest time paying their property tax bills.