D. C.
FISCAL POLICY INSTITUTE
820 First Street, NE, Suite 610, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-8173 http://www.dcfpi.org

November 26, 2003

CONCERNS WITH THE PROPOSED 10 PERCENT PROPERTY TAX CAP

By Ed Lazere

Home values have risen sharply in many DC neighborhoods in recent years, a sign of the District's strong real estate market and its resurging popularity as a place to live. These increases also have led to rising property tax assessments — and thus higher property tax bills — for many homeowners.

In response to concerns over rising tax bills, the DC Council enacted caps in 2001 and 2002 that limit tax increases to 25 percent per year. This year, new legislation was introduced to set the cap at 10 percent. That legislation was passed out of the Finance and Revenue Committee on November 25 and may be addressed by the full DC Council in December.

While the effort to relieve growing property tax bills is understandable, the proposed 10 percent cap raises some serious issues — and suggests that other approaches should be considered.

The Tax Cap Would Have High Costs: The 10 percent tax cap would reduce property tax revenues \$22.5 million in 2004. This would add to the \$17 million in tax relief already provided by the 25 percent cap. Supporters of the tighter cap have not identified a way to address the loss of revenue. It seems likely that the cap would have to be paid for by cutting spending on public services.

This point is critical. While tax relief may be an important goal, it must be weighed against other competing priorities. It is worth noting that a survey of residents at the Citizens' Summit held in November 2003, found that *"tax relief" ranked 14th among 21 priorities*. Other issues, such as providing health insurance to the uninsured and addressing the city's affordable housing shortage, ranked much higher.

The Tax Cap Would Result in Uneven Benefits across the District: It is likely that a large share of the relief from the cap would go to owners of DC's most valuable homes and to the higher-priced neighborhoods where the real estate market is strongest. An analysis of the 25 percent cap conducted by the DC Fiscal Policy Institute earlier this year found that more than half of the benefits are going to owners of homes worth \$500,000 or more, even though they represent only eight percent of DC homes.[1] Owners of homes worth \$750,000 or more are receiving an average tax reduction of \$1,900 from the 25 percent cap. Meanwhile, 60 percent of

[1] See "DC's Property Tax Cap: High Costs, Uneven Benefits," January 2003 (http://www.dcfpi.org/1-22-03tax.htm)

DC homes are worth less than $250,000, but these owners are receiving only 15 percent of the benefit of the 25 percent cap.

While the benefits of the 10 percent cap would be distributed more broadly, it is likely that a disproportionate share of the relief would go to owners of the most valuable homes.

The Tax Cap Would Result in Unequal Tax Treatment between Neighbors: Under the 10 percent cap, two neighbors living in homes that are virtually identical could pay vastly different property tax bills if they bought their homes at different times, even just a few years apart. This is because the tax cap would not apply in the year a home is purchased. The tax cap would effectively tax new residents of the District at higher rates that existing homeowners.

The Tax Cap Would Give Substantial Tax Relief to Wealthy Households already benefiting from large <u>local</u> and <u>federal</u> income tax cuts: High-income residents in the District have benefited substantially in recent years from federal and local income tax cuts. Families earning between $100,000 and $200,000 will pay an average of $3,700 less in federal income taxes in 2003 — and $550 less in DC income taxes — as a result of tax reductions enacted in recent years. The federal tax reduction for families with incomes of $1 million or more averages $113,000.[2] Given these large reductions, it is not clear that a property tax relief mechanism that provides the greatest benefits to high-income residents is warranted.

Is there a Better Way?

It seems reasonable that property tax relief should be considered in the District. The following principles and recommendations would help ensure that relief is provided in an affordable and equitable way.

The costs of tax relief must be considered: Property tax relief should be considered in the context of the District's overall budget debate for the upcoming fiscal year. This would help make clear the tradeoffs involved, namely whether providing tax relief requires making cuts in other program areas or limits the ability to fund other important public priorities.

More equitable forms of tax relief should be considered: Property tax relief, if affordable, could be provided in other ways, such as increasing the $30,000 homestead deduction or lowering the property tax rate. Both of these methods would ensure that homeowners throughout the District receive tax relief. An increase in the homestead deduction would provide the same amount of tax relief to all homeowners. A $20,000 increase in the homestead deduction, for example, would provide $192 in tax relief to all homeowners. A decrease in the property tax rate would provide roughly the same *percentage* reduction in tax bills to all homeowners.

[2] The federal income tax reduction figures are from the Brookings Institution-Urban Institute Tax Policy Center. The $550 DC income tax reduction reflects the tax cut for a family of four with $150,000 in income, as estimated by DCFPI.