



The New Property Tax Revolt in Texas

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Texas citizens have launched a new property tax revolt not unlike that launched by Prop 13 in California in the 1970s. Governor Abbott recently called a special session of the Texas legislature to enact property tax reforms. This year Texas citizens have used the initiative process to propose seventeen new amendments to the constitution, some of which are designed to provide tax relief.

It is not hard to understand why Texas homeowners are revolting against property tax burdens. Texas ranks 6th in the nation in effective property tax rates per home. The median real estate taxes paid by Texas homeowners was \$3520, compared to the national median rate of \$2690. Property tax burdens in Texas continue to outpace that in other states, and inflation in recent years has widened that gap.

The fundamental problem for homeowners in Texas and other states is inflation. In recent years we have experienced double-digit increases in inflation, comparable to that in the 1970s. Indeed, the assessed value of homes has outpaced increase in inflation in recent years. Some homeowners are being priced out of their homes because they can't afford to pay the higher property taxes. Potential homeowners are priced out of the market by higher interest rates as well as higher home prices. Homeowners ask why they should bear higher property taxes simply because of inflation.

Local governments in Texas are the major beneficiaries of inflation, capturing a windfall of revenue when inflation increases property taxes. But Texas homeowners ask the obvious question, why should local governments capture a windfall of revenue simply because the federal government fails to stabilize prices. The answer of course is that they shouldn't.

Economists often defend property taxes by pointing to the benefits of property taxes compared to other taxes. For example, the Tax Foundation recently published a study showing that decreasing property taxes with offsetting increases in other taxes, including income and sales taxes, results in a less efficient tax system.

There is a fatal flaw in the Tax Foundation analysis. The study assumes that local government revenues and spending are at an optimum level. But when local governments capture a windfall of revenue due to inflation, revenue and spending exceed optimum levels by definition. The challenge for local governments in this situation is to reduce property taxes to offset inflationary increases in assessed values. Some local jurisdictions in Texas do in fact offset increases in assessed values with decreases in the mileage rate, but these are the exceptions. Most local governments spend the windfall in revenue in response to pressure from special interests.

The challenge for Texas homeowners is how to protect themselves from inflationary increases in the assessed value and property taxes on their homes. Inflation is a failure of the federal government over which they have little control. They must rely on fiscal rules that limit the amount of property taxes they must pay. Texas homeowners are especially frustrated because over the years the Texas Constitution has been amended many times to incorporate fiscal rules designed to limit property taxes, including assessment limits, millage rate limits, and limits on the total property taxes levied.

The problem is that these fiscal rules are poorly designed and less effective than property tax limits imposed in other states. For example, the Texas Constitution caps increases in assessed value of homes at 10 percent over the previous assessment and may not exceed market value if market value is less than assessed value. That assessment limit is less stringent than that imposed in other states. In the following section we explore 2nd generation fiscal rules that have proven to be most effective in constraining property taxes.

Homeowners must be protected from burdensome taxes and the proven way to do so is with the second-generation fiscal rules. A combination of fiscal rules is required to protect taxpayers, and those rules must be incorporated in the Constitution to constrain taxes in the long term. Second-generation property tax rules are designed to protect individual homeowners as well as citizens as a whole. These rules are based on fiscal rules that have proven to be successful in the long term: Prop 13 has proven to be effective in protecting individual homeowners in California for half a century; the Taxpayer Bill of Rights (TABOR) has protected taxpayers in Colorado for more than three decades. Both of these fiscal rules are required to protect taxpayers from burdensome taxes at the local level.

California's Prop 13 caps the increase in assessed value of a home to the lesser of the free market value; or the previous year's value plus the lesser of two and a half percent, or the percentage change in the Consumer Price Index. The millage rate is capped at the level in place when the property tax limit is enacted. Voter approval is required for any increase in the millage rate.

California's Prop 13 has saved individual homeowners in California from inflationary increases in their property taxes. Polls show that citizens in California continue to support Prop 13 despite many attempts to weaken or eliminate it. Similar property tax limits have been enacted in Florida and other states as well.

Colorado's Taxpayer Bill of Rights (TABOR) caps the increase in local revenue and spending at the sum of inflation and an adjustment for local economic growth. When a local jurisdiction receives revenue in excess of that limit it must reduce taxes. In Colorado when local jurisdictions receive revenue in excess of the revenue limit, they often reduce the millage rate on property to bring revenue within the limit. However, TABOR gives local jurisdictions some flexibility in adjusting taxes to keep revenue within the limit. Local jurisdictions sometimes decrease the millage rate in advance in order to avoid the penalties that are incurred if they exceed the limit. If a local jurisdiction wants to increase the millage rate or spend revenue in excess of the revenue limit they must have voter approval.

TABOR also requires voter approval for any new tax or increase in existing tax rates. Further, if a jurisdiction wants to keep and spend revenue above the limit, it must have voter approval. Over the years hundreds of these ballot measures have been presented to voters in Colorado. Many of the ballot measures have been approved at the local level, reflecting citizen's perception of the benefits of local government services relative to tax burdens. At the local level citizens can observe and monitor how their property tax dollars are spent.

TABOR has saved Colorado taxpayers from unconstrained growth in revenue and spending at the local level for over three decades. Polls show that the majority of Colorado citizens continue to support TABOR despite many attempts to weaken or eliminate it. TABOR type tax and expenditure limits have been enacted in other states as well.

It is important to emphasize that TABOR does not protect individual homeowners from inflationary increases in the assessed value of their property and burdensome property taxes. Both Prop 13 and TABOR fiscal rules should be enacted and should be incorporated in the state constitution to protect property owners in the long term. When the fiscal rules are incorporated in the constitution it is more difficult for legislators to circumvent the fiscal rules through statutory law.

A basic principle in the Texas Constitution is that citizens should decide how much taxes they are willing to pay. Unfortunately, Texas has failed to protect homeowners from burdensome taxes on their homes.

Is there anything more demeaning than thousands of Texas citizens showing up at their assessor's office pleading for relief from property taxes. The two fiscal rules proposed in this study would protect Texas homeowners from inflationary property tax burdens. Indeed, the proposed fiscal rules would reverse the role of homeowners and local governments. With the two fiscal rules in place, it would be up to local governments to plead the case for more taxation. If a local government wants to increase assessment rates, or millage rates it must have voter approval. If a local government wants to increase the cap on revenue and spending or spend surplus revenue in excess of the spending cap it must have voter approval. Local governments must propose ballot measures that inform citizens of the purpose of a proposed tax or expenditure and the cost to taxpayers.

The experience with these ballot measures is that they often pass at the local level but not at the state level. At the local level citizens can observe how their tax dollars are spent. When local governments propose increased taxes to fund a specific project, such as a school, library, firehouse etc., these ballot measures are often approved by voters. Citizens can observe how their local governments are spending their tax dollars and hold them accountable for spending their tax dollars efficiently. At the state level it is more difficult for citizens to observe how their tax dollars are spent, and hold elected officials accountable.

The two fiscal rules proposed in this study would restore the role of homeowners in deciding how much property tax they are ailing to pay. This would strengthen the role of local governments relative to the state government. Texas has one of the strongest federalist systems in the country and these fiscal rules would strengthen that federalist system. With effective fiscal rules incorporated in the constitution, Texas' federalist system would be a model for other states, Texas should take the lead in the new property tax revolt.

Texas citizens have a long history using the initiative and referendum process to enact constitutional changes in their fiscal rules. In most states citizens do not have these rights and must depend upon their elected officials. Too often elected officials' decisions are influenced by special interests rather than the citizens they represent. Direct democracy may result in fiscal rules that benefit special interests, as revealed in the ballot measures in Texas this year; however, when citizens design and enact fiscal rules as constitutional amendments the rules are more likely to reflect citizens preferences. In the absence of direct democracy, it is easy for elected officials to enact fiscal rules and fiscal policies benefitting special interests.

Texas citizens are uniquely positioned to help launch the new property tax revolt. Texas' governor and legislature are attempting to respond to the property tax revolt. The American Legislative Exchange Council is working closely with Texas citizens in designing and enacting 2nd generation constitutional fiscal rules.

Conclusion

The tax revolt launched by homeowners in Texas is a rational response to failed government policies. The question for citizens is how to protect themselves from this government failure, not how to sustain current levels of local government revenue and spending. The question for homeowners is not only how to protect themselves from inflationary increases in property taxes, but also how to cap local revenues and spending.

When second generation fiscal rules are incorporated in the constitution it is up to citizens, not elected officials, to determine how much property taxes they are willing to pay. If local jurisdictions have used inflationary increases in revenue to boost spending the challenge is to reduce revenue and spending.

Property taxes should be reduced without offsetting increases in other taxes. Lower property taxes should mean lower levels of revenue and spending at the local level.

What we have learned after a half century of property tax revolt is that second generation fiscal rules are required to protect the property rights of citizens. Limits must be imposed on the assessed value of homes to protect the rights of individual homeowners; and limits must be imposed on the amount of property tax revenues that local governments can keep and spend. If a local jurisdiction wants to increase property taxes or other revenues, or spend revenue above the property tax limit, this should require voter approval. Prop 13 in California, and TABOR in Colorado, set the precedent for effective property tax limits. Both rules must be enacted to protect individual freedom, and the best way to enact these rules is through citizen initiative.

The new property tax revolt reveals that many citizens perceive that the government is too big, too expensive, and too intrusive in their daily lives. They are fed up with the insatiable government appetite to tax the unrealized gains in the value of their homes, and sadly many on fixed or lower incomes are forced to sell their homes because they cannot afford their property taxes. The initiative process allows citizens to decide how much government they want and are willing to pay for.



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