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Property Taxes

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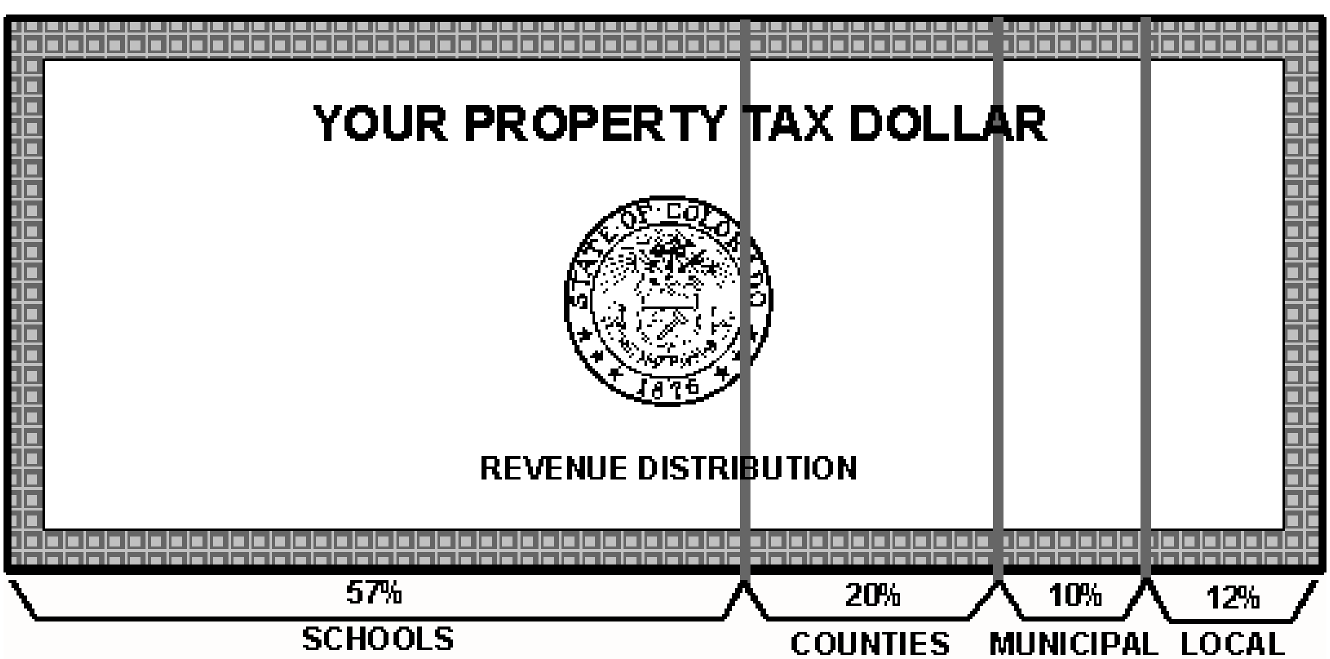
Property taxes provide the primary source of tax revenue for many local governments, comprising nearly $2.8 billion in local revenues in 1997. In 1997, property taxes were paid to the following entities in the proportions shown:



This Issue Brief discusses several aspects of the property tax, including the Gallagher Amendment, the TABOR Amendment, business personal property, and implications for changing the property tax.

How are property taxes determined? Property taxes are determined by multiplying the local tax rate (mill levy) by the taxable (assessed) value of a property. The *mill levy* is set locally by the governmental entity imposing the tax. A levy of 20 mills means that a property owner will pay $20 for each $1,000 of assessed value. The constitution requires that mill levies apply uniformly to all property within a jurisdiction. Thus, all taxpayers in a county pay the same county mill levy.

A property's *assessed value* represents only a portion of its market value. The portion is defined by an assessment rate while the market value is determined by the county assessor. Most assessment rates are established in the constitution and differ based on property classifications such as residential, commercial, and agricultural. Most nonresidential property is assessed at 29 percent of its market value while residential property is assessed at a rate determined by law. In 1997, the General Assembly set the residential assessment rate at 9.74 percent of market value. Thus, a home worth $100,000 would have an assessed value of $9,740.

Gallagher limits residential property taxes. Under a constitutional provision commonly called the "Gallagher Amendment," the residential assessment rate must be adjusted to maintain the shares of residential and nonresidential assessed values. Since the Gallagher Amendment was approved in 1982, the total amount of residential assessed value has been capped at roughly 45 percent of the state total; the remaining 55 percent of assessed value comes from nonresidential (business) property.

Gallagher requires that the residential rate be adjusted whenever property is revalued, currently every two years. The rate set in 1997 applies to property taxes paid in 1998 and 1999. In general, the rate must decline to keep the 45/55 proportions constant when the total value of residential property increases at a stronger pace than all other property. Conversely, the Gallagher Amendment requires an increase in the residential rate when growth in the value of nonresidential property outpaces residential property, although such an increase is prohibited under TABOR. Since 1982, the residential assessment rate has declined from 21 percent to 9.74 percent, so as to prevent owners of residential property from paying more than roughly 45 percent of all property taxes levied.

TABOR limits all taxes. Another part of the Colorado Constitution, commonly known as the "TABOR Amendment," imposes limits on property tax rates, assessment rates, and tax collections. For *tax rates*, TABOR requires voter approval to increase a mill levy or to impose a new mill levy.

TABOR prohibits an increase in the *assessment rate* for any class of property without prior voter approval. This provision primarily affects the residential assessment rate because most nonresidential rates are set in the constitution and therefore cannot be changed, either up or down, without voter approval. It means that the residential assessment rate will never be higher than it currently is, unless voters approve a change.

TABOR sets a cap on *tax revenues* equal to revenue from the prior year multiplied by a growth factor which includes the rate of inflation. For school districts, allowable growth is inflation plus the percentage change in student enrollment. For other local governments, allowable growth is inflation plus the percentage change in the actual value of all real property. Revenues in excess of these limits must be refunded, unless voters agree otherwise.

Businesses pay taxes on personal property. The General Assembly has taken a significant interest in the issue of property taxes imposed on business personal property, passing three bills to reduce or end this tax in the past two years. Although two of these bills were vetoed by the governor, a bill was signed into law in 1996 to exempt from tax any personal property schedule with less than $2,500 of actual value ($725 of assessed value). Proponents claimed that the tax was too expensive to administer, given the amount of revenue collected; opponents argued that the state should not provide tax relief by reducing a source of local revenue.

Business personal property is expected to generate an estimated $473.8 million in property taxes in 1997, representing roughly 17 percent of all property tax collections statewide. The proportion of taxes from business personal property varies widely across the state. Moffat, Morgan, and Crowley counties are most reliant on its revenue.

The property tax raises policy issues. For taxpayers, the property tax has been a traditional source of revenue for public services because it is directly related to services provided at the local level. It is also a known quantity and total collections are limited; however, its basis on wealth ignores a property owner's ability to pay. For governments, it is the primary source of revenue for many taxing jurisdictions but it is a slow-growth revenue source, and some areas do not have an adequate base and require a high mill levy to raise significant revenue. The following rules may provide guidance when considering changes to the state's property tax policy.

1. Together, the *Gallagher* and *TABOR* amendments limit the ability of government to use property taxesas a revenue source; TABOR caps total property taxes while Gallagher caps the residential share. Repealing either amendment requires a constitutional change.

2. Under the Gallagher Amendment, any effort to lower property taxes on nonresidential property, such as exemptions for *business personal property*, will also decrease the residential assessment rate and, thus, lower taxes on residential property. Without a mill levy increase, governments will collect less revenue.

3. Since the *residential assessment rate* is based on statewide values, its adjustment affects each local government differently depending on the mix of residential and nonresidential property. Regions with a high proportion of residential property and less-than-average growth in the value of residential property may actually see a lower tax base when the residential assessment rate declines.

4. The state's school finance formula automatically provides replacement revenue to school districts for most *declines in assessed value*. For other local governments, however, a reduction in assessed value will cause a reduction in property tax revenue, unless voters approve a mill levy increase.

5. Colorado uses differential assessment rates to provide *property tax relief to homeowners*, while some states use a homestead exemption or a circuit breaker to reduce residential taxes. A homestead exemption exempts a portion of the value of a home from property taxes; a circuit breaker is a state-financed property tax credit which decreases as an individual's income increases.

6. Of the three major taxes collected in Colorado (sales, income, and property), the property tax is the only major state and local revenue source that is *predominantly paid by businesses*. Thus, using other taxes as replacement for the property tax may shift more of a tax burden onto individuals.

7. For itemizers, property taxes are deductible from income taxes. As such, reducing property taxes may increase federal and state income taxes.

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