ANALYSIS OF POLICIES TO HELP LOW-INCOME PROPERTY OWNERS COPE WITH RISING TAXES RESULTING FROM HIGHER ASSESSMENTS

Pennsylvania Economy League (Eastern Division)
215 South Broad Street, Philadelphia, Pa. 19107

Report No. 431

1982

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The generosity of the

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PREFACE

The Pennsylvania Economy League has long advocated a professional system of real estate tax assessment, whereby assessments would be kept up to date with changes in market value, on a uniform and equitable basis. The Economy League is therefore gratified to note that an agreement was reached in the Spring of 1981 which should move Philadelphia toward such a system.

However, the solution to the problem of inequitable, lagging assessments might very well bring to the fore another problem--the plight of homeowners who could not cope with rising taxes resulting from higher assessments. Thus, the Economy League decided that this situation merited research attention, and sought and obtained a grant from the Thomas Skelton Harrison Foundation to prepare this study.

The study has five chapters. Chapter I discusses the need for property tax relief, while the second chapter looks at advantages and limitations of Pennsylvania's circuit breaker law for senior citizens. The third chapter reviews programs of other states, while the fourth reviews proposed legislation in Harrisburg and Philadelphia. The final chapter has a summary of the advantages and disadvantages of various alternatives.

Acknowledgements. We wish to thank the Thomas Skelton Harrison Foundation for its generous grant which helped finance this study.

A special committee of the Board of Governors of the Pennsylvania Economy League gave advice to the staff on the study. The committee included Richard J. McConnell, chairman, Robert R. Batt, Norman R. Bitterman, Robert D. Carpenter, Karl E. Wenk, and Lawrence Wilson.

Staff principal for this study was Senior Research Associate Edgar Rosenthal, assisted by Research Assistant John Conlow. Valuable help was also provided by Research Associate Marjorie L. Jacob.

Edwin Rothman
Director

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I. INTRODUCTION--A DISCUSSION OF THE NEED FOR PROPERTY TAX RELIEF FOR SOME CLASSES OF PHILADELPHIA HOMEOWNERS

The real property tax was once the mainstay of local government revenue. In Philadelphia, the real property tax has decreased in relative importance since the wage tax came on the scene in the late 1930's. But the real property tax is still an important source of revenue for the city government (accounting for 23% of local tax revenues in fiscal 1981) and the primary source of tax revenues for the school district (accounting for 75% of local tax revenues in fiscal 1981).

The administration of the tax in Philadelphia--as well as in many places throughout the nation--has come under growing criticism. A 1980 PEL report points to the wide variation in assessment ratios--relationship between assessed value for taxation and sales price.* Among Philadelphia's 66 wards, the average ratio of assessment to sales price ranged from a low of 17% to a high of 88% for residential properties (1978 data).

A major recommendation of the PEL report was that a reassessment of all real property should be initiated immediately.

In the Spring of 1981, the City of Philadelphia and City Council settled various court suits "by agreeing that all properties in the City will be subject to reassessment in order to reach level assessments over a six year period commencing in 1981 and that in any given year no reassessment shall exceed the lesser of (a) 5% of that property's 1981 fair market value, or (b) maximum yearly percentage increases between 0% and 15% of the then current assessment as necessary to reach the existing common level ratio within the number of years remaining in the six year period."**

The PEL realizes that a reassessment program annually maintained might present hardship to some homeowners if personal income does not keep pace with rising home values.

Illustration of Property Tax Impact

Real estate tax liability is determined by three variables: the market value of property, the ratio of assessment to market value (assessment ratio), and the tax rate. In Philadelphia, the average property tax appears to be about 2% of market value for residential property. Of course, with the wide variation in assessment ratios, there is a large variation around the average.

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*The Problems With Philadelphia Real Property Assessment Practices and Solutions (Report No. 417), August 1980.

**Official Statement, City of Philadelphia $60.5 Million General Obligation Bonds, 1981 Series A, Dated August 15, 1981, p. 19.

The average figure was obtained by multiplying the 1982 tax rate of 6.75% of assessed value (the school rate is 3.275% and the city rate is 3.475%) by an assumed average assessment ratio of .2963, which was the average figure reported for residential property sales in 1978. This report uses 2% of market value in its illustrations as the average residential tax liability in Philadelphia because of simplicity, even though there may have been changes in the average assessment ratio since 1978 (the latest available report data). Based on 2% of market value, here is the annual property tax bill for houses in the $20,000 to $100,000 market value range:

Value	Tax
$20,000	$ 400
$40,000	$ 800
$60,000	$1,200
$80,000	$1,600
$100,000	$2,000

The property owner's income does not affect the tax liability. Persons of different income have the same liability if their properties have the same assessed value. This is illustrated in Table 1, which shows the tax liabilities as a percentage of income for homeowners in the income range of $4,000 to $24,000. Thus, the tax burden becomes a substantial portion of income, even for homeowners at the higher end of the income range shown, when the market value is at the upper reaches ($60,000 and up) indicated in the table. At the relatively lower levels of market value of $20,000 to $40,000 shown in the table, the real estate tax equals a substantial portion of income at the lower end of the income scale.

Some may question the probability of persons with income in the $4,000 to $12,000 range owning homes with market values of $40,000 to $100,000. Certainly, the economics of home buying are such that persons in the income ranges shown could not obtain mortgages in order to purchase houses valued at $40,000 or more. Thus, the wide disparity between income and home value must be attributable to drastic changes in income or home value, or both, since the home was acquired.

The combination of high property value and low income is most likely to occur in the case of a retired homeowner. Two factors could be involved. The first is that retirement income may be only a small fraction of household income during the previous working years of the homeowner (or the homeowner's spouse, in case of a widow or a widower). The second factor is that housing values may have escalated since retirement, through a combination of general inflation and a sharp increase in the attractiveness of a particular neighborhood.

For the homeowner below retirement age, drastic income reductions may be the result of illness, death, or unemployment of the principal breadwinner.

Current statistics are not available on the number of Philadelphia home owners whose incomes are disproportionately low in relation to home values. The most recent data on housing value and income are from the 1975 sample survey of housing.*

*U.S. Bureau of the Census, Annual Housing Survey: 1975, Philadelphia, Pa.-NJ...Series H-170-75-33 (issued August 1977), p. C-35.

Table 1. Real estate tax bill as percentage of income for Philadelphia homeowner (before application of the Pennsylvania property tax circuit breaker) at four income levels and various property valuations: 1982

Household income	Real estate tax as percentage of income			
	$20,000 market value home ($400 tax)	$40,000 market value home ($800 tax)	$60,000 market value home ($1,200 tax)	$100,000 market value home ($2,000 tax)
$ 4,000	10.0	20.0	30.0	50.0
$ 6,000	6.7	13.3	20.0	33.3
$12,000	3.3	6.7	10.0	16.7
$24,000	1.7	3.3	5.0	8.3

Assumptions as to tax rate in relation to market value: Philadelphia's tax of 67.50 mills, applied to assessed value based on an assessment ratio of 29.63%.

Note: At the end of May 1982, City Council raised real estate taxes, effective for Fiscal 1983 (July 1, 1982 through June 30, 1983).

The survey showed that Philadelphia had 342,700 owner-occupied one-family homes. About 14%--49,300 homeowners--lived in homes with values four or more times the income of the homeowner. If real estate taxes equal 2% of market value, the tax bill would be at least 8% of income for such homeowners.

Additionally, the survey showed average real estate taxes in relation to home values, as well as home values by income class. Based on the data, the PEL has prepared Table 2, showing the approximate distribution of households by tax burden as percentage of income in 1975. About 30,000 homeowners paid taxes equalling 10% or more of income. Most of these were concentrated in the lowest income group, those with reported income of under $3,000 in 1975.

The data may not be entirely accurate, because some economists question whether the income reported by the lowest income group includes all transfer payments. Also, there may be changes since 1975. In any event, the 1975 survey figures do indicate that there are a considerable number of homeowners (although a small proportion of total homeowners) who pay a high proportion of income in real estate taxes. The majority of low income homeowners were 65 and over, and the fact that 80% of those with incomes under $5,000 owned their homes free and clear would indicate that most are aged who have paid off their mortgages.

Another indication of the number of aged homeowners with incomes under $9,000 is given by data on Philadelphia's experience under the Pennsylvania circuit breaker program (Chapter II). For 1978, 47,000 senior citizen homeowners received benefits; they reported tax payments (before rebates) averaging 7% of total income.

The report of the Pennsylvania Tax Study Commission (March 1981) updated figures from the U.S. Bureau of the Census housing surveys and found that average tax payments represented a high percentage (e.g., 24.7% in the under $3,000 income group) for low-income Pennsylvanians.*

How High is Too High?

Opinions differ as to when a property tax represents too high a percentage of income, and becomes so burdensome that paying the tax would force excessive cutbacks in other parts of the budget (e.g., for food, fuel, utilities, medical expenses). However, there are some rough standards available.

The Advisory Commission on Intergovernmental Relations (ACIR), in model property tax relief measures proposed in 1975, suggested that when property taxes exceed between 4% to 6% of income, some relief should be granted.** The standard of 4% was suggested as perhaps applicable to the lower income household while a standard of 6% would apply to higher income levels.

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*Final Report of the Pennsylvania Tax Commission (Richard M. Cyert, Chairman), March 1981, p. 24.

**ACIR, Property Tax Circuit Breakers: Current Status and Policy Issues (Washington, D.C., 1975), p.32.

Table 2. Approximate distribution of Philadelphia households by average real estate taxes as percentage of income, for owner-occupied housing units: 1975

Real estate taxes as percentage of income	Number of households (000's)							
	Income under $3,000	Income $3,000 to $4,999	Income $5,000 to $6,999	Income $7,000 to $9,999	Income $10,000 to $14,999	Income $15,000 or more	Total Number	Total %
Less than 4%	-	-	13.8	30.5	75.6	126.5	246.4	71.9%
4-5%	-	19.7	7.7	7.3	2.9	1.1	38.7	11.3%
6-7%	2.0	8.8	5.6	1.4	.8	-	18.6	5.4%
8-9%	4.5	1.7	2.1	.3	-	-	8.6	2.5%
10% or more	26.4	3.4	.6	-	-	-	30.4	8.9%
Total	32.9	33.6	29.8	39.5	79.3	127.6	342.7	100.0%

Note: Real estate tax payments were calculated based on average taxes per $1,000 of value of housing, and then related to the mid-point of each income group. This methodology gives an approximate distribution of average tax payments in relation to income, but not a precise distribution, since actual tax payments may deviate from the average.

Source: Computed by PEL, from U.S. Bureau of the Census, Annual Housing Survey: 1975, Philadelphia Pa.-NJ, Series H-170-75-33 (issued August 1977), p. C-35 and p. C-40.

Another rough measure of "how high is too high" may be provided by data on average real estate tax payments in relation to income as shown in recent PEL comparative tax studies. For a "model" $20,000 family (family with an income of $20,000 owning a home with market value of $40,000), the PEL calculated real estate taxes as 4.3% of income in Philadelphia in 1978; in other large cities, the range was 2.2% to over 10%. In the comparisons with municipalities in Southeastern Pennsylvania, the PEL model showed that the real estate tax for the $20,000 family equaled between 3.5% and 5% of income in the Pennsylvania suburban counties, and 5.5% to 7% in the New Jersey counties.*

The real estate tax burden in Philadelphia in these studies was average; however, <u>the total local tax burden</u>, taking into account the Philadelphia wage tax, was the highest in the study. This illustrates the fact that it would be improper to evaluate the real estate tax burden in isolation. A real estate tax burden equalling 5% of income may be excessive, if combined with other local taxes, such as income or sales taxes, but may be average or below average if there are no other local taxes which the homeowner has to pay.

In any event, for this study, it is assumed that when the real estate tax equals more than 10% of income there may well be a problem of excess burden, and that a real estate tax burden in the range of 6% to 9% may also raise questions of excess burden.

Elderly Income

This study is concerned with the question of the property tax burden of those with fixed or low income, particulary the elderly. Data are not currently available on the income of elderly in Philadelphia, but national data would provide some approximation of typical levels.

For elderly homeowners <u>living alone</u> in central cities in 1978, the mean income was $6,279; for the same group, the median was $4,838.**

It should be noted that the average income of elderly households appears to increase substantially when two or more persons occupy a household. In 1979, the median <u>family</u> income when the principal owner or occupant was 65 or over was $11,316, nationwide.***

Many of the illustrations of this report will deal with three income levels: $4,000 and $6,000, as representative of two levels of those elderly living alone, and $12,000 as representative of the level of the elderly homeowner with a family of two or more.

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*Pennsylvania Economy League, <u>Taxes in Philadelphia Compared to Nearby Municipalities--1979-80</u> (Report No. 413, March 1980).

**U.S. Bureau of the Census, <u>Current Population Reports</u>, Series P-60, No. 123, "Money Income of Persons and Families in the U.S., 1978," p. 77.

***U.S. Bureau of the Census, <u>Current Population Reports</u>, Series P-60, No. 125, "Money Income and Poverty Status of Families and Persons in the U.S. (Advance Report)," October 1980, p. 16.

Census Bureau figures show that approximately one out of seven elderly persons have annual incomes that are below the poverty level, and that a significant number have incomes that hover just above the poverty level. Thus, for Philadelphia, 25% to 30% of the elderly are at or close to the poverty level. Data on how many of these elderly are homeowners are not available.

Another indication of the possible income levels for use as illustrations of taxes in relation to income is provided by the U.S. Bureau of Labor Statistics presentation of the "Three Budgets for a Retired Couple, Autumn 1979." For Philadelphia the lowest of the three budgets was pegged at $5,870; the intermediate at $8,891 and the high at $13,174.

Views As to Problem

Is it a problem to own a property with value far greater than can be supported by current income? Some might say that the problem, if there is one, is readily solved, since the homeowner can sell the property, cash in on the appreciated value, and move to a neighborhood more in keeping with income. Others, however, would respond that sale is not a solution; that a long-time homeowner should not be forced out of a neighborhood because of inability to afford rising property taxes; and that some devices should be available to provide property tax relief, so that the long-term homeowner can live out the remainder of his or her years in the old neighborhood, if this is desired.

To recapitulate, the possibility of property tax relief for two classes of homeowners with fixed or limited income merits analysis: the owner living in an area of continuously escalating home values and assessments; and the owner whose assessment is suddenly increased dramatically because of a reassessment program.

Purpose and Outline of Remainder of Report

The purpose of this report is to review and analyze various property tax relief mechanisms in order to determine to what extent the relief mechanisms help solve the problems mentioned above. The study turns first to an examination of Pennsylvania's "property tax circuit breaker" for aged and disabled, to ascertain to what extent the circuit breaker meets the problem. The report then reviews property tax relief measures in other jurisdictions and their relationship to the problems. Next, the report reviews recent proposals in Philadelphia and elsewhere. The final chapter presents a summary and advantages and limitations of the various programs.

II. THE PENNSYLVANIA CIRCUIT BREAKER: ADVANTAGES AND LIMITATIONS FOR MEETING THE PROBLEM

Since 1971, Pennsylvania has had a "circuit breaker" to provide property tax relief for the elderly 65 and over. The term "circuit breaker" was coined to describe programs designed to protect homeowners from a tax overload, just as the electrical circuit breaker provides protection against an electrical overload by interrupting a circuit under abnormal conditions.

The first circuit breaker property tax relief program in the United States was instituted by Wisconsin in 1964. Since 1964, at least 28 other states plus the District of Columbia have followed suit.*

The assumption underlying all circuit breakers is that residential property tax relief should be geared to the income levels of the taxpayers. Chapter III describes programs in other states.

Constitutional Basis for Pennsylvania's Circuit Breaker

Pennsylvania's circuit breaker was made possible by 1968 amendments to the state constitution. Pennsylvania's constitution (dating back to 1873) has a requirement that all taxes shall be uniform upon the same classes of subjects. The 1968 amendments retained this requirement, but also provided that the General Assembly may permit special tax exemptions or provisions for citizens in need because of "age, disability, infirmity or poverty." The amendment further specifies that the General Assembly shall not grant any exemption for any tax on real property unless the General Assembly also provides for the reimbursement of local government by or through the state for losses.**

Circuit Breaker Law

The 1971 Pennsylvania circuit breaker law is entitled the "Senior Citizens Property Tax Assistance Act" (March 11, 1971, P.L. 104, No.3).*** The purpose, according to the legislative declaration of policy, was to provide property tax rebates to elderly homeowners "who are without adequate means of support to enable them to remain in peaceable possession of their homes and relieving them of their economic burden." The declaration also states that the law reflects "the mandate of the Constitutional Convention of 1968."

The law has since been amended to extend eligibility. Originally limited to persons age 65 or older, the law now applies also to widows/widowers age 50 or older, and to permanently disabled persons of any age. While originally

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*Steven D. Gold, Property Tax Relief (Lexington, Mass.: Lexington Books, 1979), p. 56.

**Pennsylvania Constitution, Article VIII, Section 2, (b) (ii), as amended 1968. The text is reproduced in Appendix A.

***P.S. Sec. 4751-1.

limited to homeowners, the law now also provides benefits for elderly, widowed or disabled renters.

Benefit Formula

As amended in 1982,* the circuit breaker provides benefits to eligible owners and renters if income falls below $12,000. The schedule is shown in Table 3. For example, homeowners with income under $5,000 receive a rebate of 100% of property taxes, up to the maximum rebate of $500. As income increases, the percent of property taxes rebated decreases, so that a homeowner with the maximum allowed to qualify ($11,999) will receive a rebate of only 10% of property taxes.

The circuit breaker applies also to renters (except those on public assistance). For renters, it is assumed that 20% of the gross rent is, in effect, used to pay property taxes. For example, for income under $5,000, while a homeowner will receive a rebate of 100% of property taxes, a renter will receive a rebate equal to 20% of rent--that is, 100% of the amount calculated as being paid in property taxes. At the $11,999 income level, a renter receives a rebate of 2% of rent--that is, 10% of the figure (20% of rent) calculated as equivalent to property taxes.

The maximum amount for property tax or rent rebate payable is $500.

However, in addition to property tax or rent rebates, a 1979 amendment to the act provided for "inflation dividends." The 1982 amendment calls for such payments ranging from $125 (for those with household income of less than $5,000) down to zero (at $12,000 income level).

Thus, the maximum payments under the act range up to $625. Rebates are paid in July; dividends in December of the year.

The inflation dividend is intended to meet inflation expenses which "include but are not limited to the additional cost of medical prescriptions, energy needs, transportation and food and clothing essentials."**

Income from the Pennsylvania circuit breaker is defined as all income from whatever sources, including wages and salaries, interest and dividends, Social Security (except Medicare), Supplemental Security Income, and Veterans' disability payments, pensions or annuities. Also included as reportable income are: life insurance death benefits in excess of $5,000; all gifts of cash or property when the total value exceeds $300 (except between members of a household); and the full amount of any realized capital gains. Income is further defined as the combined annual income of claimant and spouse.

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* Act 56 of 1982.

** 72 P.S. Sec. 4751-3 (9).

Table 3. Rebates and dividends under Pennsylvania's circuit breaker: 1982

Household income	Rebate percentage factor Owners*	Renters**	Inflation dividend
0- $4,999	100%	20%	$125
$ 5,000- 5,999	80	16	100
6,000- 6,999	60	12	75
7,000- 7,999	40	8	60
8,000- 8,999	20	4	45
9,000-11,999	10	2	30
12,000 and over	0	0	0
	Maximum rebate is $500		

Examples: Computing the rebate, using the claim form, property owner:

Line		
10	Total income of claimant and spouse in 1981	$6,000
11	Amount of 1981 property taxes	$ 800#
12	Rebate percentage factor (from table)	60%
13	Property tax rebate in 1982	$ 480##

Computing the rebate, using the claim form, renter:

Line		
10	Total income of claimant and spouse in 1981	$6,000
11	Amount of rent paid	$2,400
12	Rebate percentage factor (from table)	12%
13	Rent rebate	$ 288##

* Percentage times property tax
** Percentage times rent
\# Assuming $40,000 market value of property
\## Plus inflation dividend of $75.

Source: Pennsylvania Department of Revenue, "1981 Property Tax or Rent Rebate Program" (April 1982).

Financing of the Act

Payments (rebates) and administrative expenses are financed from the Pennsylvania State Lottery Fund (Act of August 26, 1971, P.L. 351, No. 91).

Claims for payments, appeals, and other administrative matters are handled by the Pennsylvania Department of Revenue.*

The deadline for filing claims is June 30 of the year immediately following the year the tax was paid. However, claims filed between June 30 and December 31 will be paid, if sufficient funds are available for late filers. If the amount required for timely claims and administrative expenses exceeds the amount in the fund, then the amount allowed as claims must be proportionately reduced.

Benefits Related to Income and Property Values

The Pennsylvania circuit breaker rebates a percentage (up to a maximum) of property taxes, depending on the homeowner's income. Within a given income range, the homeowner with the highest gross property taxes will receive the largest rebate, but still pay a larger percentage of income than another homeowner with lower property taxes (except when 100% of the tax is rebated for households of income under $5,000).

This same relationship holds true for market values when the assessment ratio and tax rate are held constant. Within a given income range, the higher the market value, the higher the tax bill, the larger the rebate, and the higher the property taxes will be as a percent of income. This is illustrated in Table 4.

For instance, with $6,000 income, the owner of a $40,000 home receives a rebate of $480. The owner of a $20,000 home receives a $240 rebate. Thus, despite receiving the larger rebate, the owner of the $40,000 home has a net tax bill of $320, 5.3% of his income; the owner of the $20,000 home pays a net tax bill of $160, or 2.7% of income.

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* For 1979, 58,497 homeowners were granted rebates in Philadelphia County. Homeowners reported that tax payments before rebates equalled 7% of income. By category, the claimants were distributed as follows:

Age 65 or over	45,667 homeowners
Widow/widower age 50 or over	7,799
Permanently disabled	4,761
Claimants' eligibility terminated	270
	58,497

Source: Commonwealth of Pennsylvania, Department of Revenue, "Statistical Report, Property Tax or Rent Rebates . . . for 1979."

Table 4. Real estate tax bill as percentage of income for elderly Philadelphia homeowner--before and after the application of the Pennsylvania property tax circuit breaker (three income levels and four property valuations): 1982

Household income	Real estate tax bill							
	$20,000 m.v. home		$40,000 m.v. home		$60,000 m.v. home		$100,000 m.v. home	
	before C.B.	after C.B.	before C.B.	after C.B.	before C.B.	after C.B.	before C.B.	after C.B.
$4,000								
Tax dollars	$400	0	$800	$300	$1,200	$700	$2,000	$1,500
% of income	10.0%	0	20.0%	7.5%	30.0%	17.5%	50.0%	37.5%
$6,000								
Tax dollars	$400	$160	$800	$320	$1,200	$700	$2,000	$1,500
% of income	6.7%	2.7%	13.3%	5.3%	20.0%	11.7%	33.3%	25.0%
$12,000								
Tax dollars	$400	$400	$800	$800	$1,200	$1,200	$2,000	$2,000
% of income	3.3%	3.3%	6.7%	6.7%	10.0%	10.0%	16.7%	16.7%

Notes: C.B. stands for circuit breaker, the benefit payable under the Pennsylvania Senior Citizens Property Tax Assistance Act of 1971, as amended.

Assumptions as to tax rate in relation to market value (m.v.): Philadelphia's tax of 67.50 mills, applied to assessed value based on an assessment ratio of 29.63%. (Tax rate was raised at end of May 1982, applicable to real estate taxes for fiscal 1983)

Circuit breaker benefit equals property tax times rebate factor.
At $4,000 income: 100% of tax to maximum of $500 rebate (plus $125 inflation dividend).
At $6,000 income: 60% of tax to maximum of $500 rebate (plus $ 75 inflation dividend).
At $12,000 income: Not eligible for circuit breaker benefits.

Inflation dividends are not included in above computations.

Limitation of the Circuit Breaker

The major limitation of the Pennsylvania circuit breaker is that some homeowners, despite receiving a rebate, will continue to pay a high percentage of income for property taxes. A major factor is the ceiling on rebates.*

This is illustrated in Table 4. Where the tax bill is $800 or more (market value of $40,000 or more), there is no guarantee that property taxes will become affordable even though the taxpayer receives a rebate. For instance, at the $4,000 income level, a homeowner with a $40,000 home (tax bill of $800) would pay a net tax, after rebate of $500, equal to 7.5% of income; if the home value rose to $60,000 (tax bill of $1,200), the property tax would equal 17.5% of income. (At the $4,000 income level, the circuit breaker pays 100% of the tax bill, to the maximum $500 rebate.)

At the $6,000 level, Table 4 also illustrates that the net tax bill can be a high percentage of income once housing values reach $60,000 or more.

The circuit breaker does not apply to incomes of $12,000 or more. Table 4 has illustrations of taxes paid by a homeowner with $12,000 income. With a $60,000 home, the tax bill equals 10% of income; with a $100,000 home, almost 17%.

It is obvious that the homeowners in the low to moderate income ranges in the illustration could not have purchased their houses unless, at the time of purchase, their incomes had been much higher in relation to the value of the house. The disparity between income and home value in the illustrations could have been occasioned by a drop in income (after retirement) or by escalating housing values, or a combination of the two.

Another possible limitation of the circuit breaker program is that it does not take into account household size. At a given income level, the same percentage rebate is offered to one-person households as to households with two or more persons.

Finally, of course, the circuit breaker is designed to meet the needs only of certain classes of persons--elderly, widowed, and disabled. Other low income property owners who are not aged, widowed, or disabled also may pay high property taxes in relation to current income.

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* On a statewide basis, about 15% of claims paid for 1978 were the then $400 maximum rebate. Ibid., pp. 4-6. The 1982 ceiling is $500.

III. REVIEW AND ANALYSIS OF PROPERTY TAX RELIEF POLICIES ADOPTED IN OTHER STATES

The previous chapter has shown the shortcomings of the Pennsylvania property tax circuit breaker in meeting completely the property tax problem which is the focus of this report: high property taxes in relation to the income of the elderly or fixed-income Philadelphia homeowner living in an area of escalating property values.

This chapter reviews and analyzes property tax relief programs in other states and their applicability to the problem.

To assist analysis, the discussion will provide illustrations of how such mechanisms would aid a family discussed earlier: the aged homeowner living in Philadelphia with a home valued at $60,000, a tax bill of $1,200, but an income in the range of $4,000 to $12,000.

Several excellent publications are available on different aspects of property tax relief programs throughout the nation. The analysis in this chapter relies heavily on these sources:

(1) Steven Gold, Property Tax Relief (Lexington, Mass: Lexington Books, 1979).

(2) Advisory Commission on Intergovernmental Relations (ACIR). ACIR is the principal organization nationally that compiles information on property tax relief programs by state. Particularly useful are Property Tax Circuit Breakers: Current Status and Policy Issues (1975), and the update on the status of circuit breakers, Significant Features of Fiscal Federalism, 1978-79. The same report title for 1976-77 provides a detailed review of homestead credits and exemptions.

(3) Abt Associates, Property Tax Programs for the Elderly, A Compendium Report (Cambridge, Mass: April 1975). Prepared for the U.S. Department of Housing and Urban Development.

(4) Peter S. Fisher, A Critique of the Rationales for Circuit-Breaker Property Tax Relief with an Emphasis on Fiscal Equalization Objectives (Iowa City, Iowa: The Institute of Urban and Regional Research, January 1980).

The Circuit Breaker Elsewhere

In 1980, state financed circuit breakers operated in 29 states and in the District of Columbia. Of the 30 programs, no two were identical.

All circuit breakers are intended to provide property tax relief when the property tax is deemed excessive in relation to income. But as noted in the prior chapter, Pennsylvania's circuit breaker is not effective in this regard for Philadelphia's low income homeowners with homes valued at $40,000 and above. This chapter looks at the circuit breakers in other states to determine whether some do better in meeting this problem.

Rationale for Circuit Breaker

The Advisory Commission on Intergovernmental Relations (ACIR) is one of the chief proponents of circuit breakers. ACIR notes that "the property tax can quickly create a disproportionate claim on a family's financial resources once retirement, the death or physical disability of the breadwinner, or unemployment reduces sharply the flow of income." As a means of preventing fiscal overburdens, the ACIR points to the following "unique advantages" of state-financed circuit breakers:

> Because this tax relief program is financed from state funds, it neither erodes the local tax base nor interferes in any way with the local assessment or rate-setting process.
>
> It can be designed to maximize the amount of aid extended to low-income homeowners and renters while minimizing loss of revenue.
>
> It operates to reduce intergovernmental fiscal disparities between high and low-income communities as well as reducing disparities between high and low-income persons.*

Benefit Formulas

There are two basic approaches to circuit breaker benefits--the sliding scale and the threshold formula.

The essence of a sliding scale formula is that the percentage of tax rebate varies with income. Pennsylvania's program embodies the sliding-scale approach. Next to the threshold approach (discussed below), the sliding scale was the most common formula in use among the states in 1978. See Table 5.

The threshold formula provides rebates for the amount of property taxes which exceed a "threshold"--a certain percentage of income. The threshold may be the same for all income levels; more typically, the threshold rises with income. For example, under the Vermont threshold formula, persons with incomes of under $4,000 receive a rebate of taxes in excess of 4% of income; persons with incomes exceeding $16,000 receive a rebate of taxes in excess of 6% of income.

There are two other distribution formulas which are variants of the sliding scale. One is the variable credit (a flat dollar amount) which decreases as income increases; the other, a variable reduction in assessed value, with the reduction decreasing as income increases.

Both ACIR and Gold have detailed reviews of the advantages and disadvantages of the threshold as compared to the sliding scale formulas.**

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*ACIR, Property Tax Circuit Breakers, p.27.

**Ibid., p. 9-10; Gold, p. 63-65.

Table 5. Circuit breaker programs in 30 states: 1978 (1)

Coverage (2)	Maximum benefit	Average benefit (3)	Maximum income	Type of relief formula (4)
Elderly Homeowners				
Arkansas	$500	$76	$8,000	Variable threshold (percentages not available)
Idaho	400	231	7,500	Variable credit ($75-400)
North Dakota	BAV	120	8,000	Variable reduction in assessed valu ($800-4,000)
Ohio	BAV	135	10,000	Variable reduction in assessed valu ($2,000-5,000)
Oklahoma	200	86	6,000	Simple threshold (credit for taxes exceeding 1% of income)
South Dakota	NA	99	4,625(s) 7,375(m)	Sliding scale (19-55% of tax rebated)
Elderly homeowners and elderly renters				
Arizona	225	200	3,750(s) 5,500(m)	Variable credit ($25-225)
California	NA	266	20,000(gross) 12,000 (net)	Sliding scale (4% to 6% of tax reba
Colorado	410	187	7,300(s) 8,300(m)	Maximum credit of $410 is reduced by 10% of income when income exceeds $3,000(s) and $4,300(m)
Connecticut	400	244	6,000	Simple threshold with sliding maximum credit. (Credit for taxes exceedin 5% of income. Maximum credit range from $50-$400.)
Illinois	700	250	10,000	Simple threshold (credit for taxes ex ceeding 4% of income)
Indiana	500	29	5,000	Sliding scale (10-75% of tax rebated)
Iowa	600	115	9,000	Sliding scale (25-100% of tax rebate
Kansas	400	140	8,150	Variable threshold (credit for taxes that exceed 0%-13% of income)
Maine	400	209	5,000(s) 6,000(m)	Variable credit (credit for taxes up to $400)
Missouri	500	125	7,500	Variable threshold (credit for taxes that exceed 0-4% of income)

Table 5. Circuit breaker programs in 30 states: 1978 (continued)

Coverage (2)	Maximum benefit	Average benefit (3)	Maximum income	Type of relief formula (4)
Nevada	$300	$128	$11,000	Sliding scale (10-90% of tax rebated)
New Mexico	250	38	16,000	Maximum property tax liability in dollars for various income classes
PENNSYLVANIA	400	142	7,500	Sliding scale (10-100% of tax rebated)
Rhode Island	150	52	5,000	Variable threshold (Credit equals taxes that exceed 3%-7% of income)
Utah	500	95	7,000	Sliding scale (20-95% of tax rebated)
West Virginia	94	14	5,000	Variable threshold with co-insurance feature. (Credit equals 30-75% of taxes exceeding 0.5%-4.5% of income, plus other adjustments)
All homeowners and renters				
Dist. of Columbia	400	100	10,000	For non-elderly homeowners: Variable threshold with co-insurance feature. (Credit equals 80%-95% of taxes exceeding 2%-4% of income.)
	750	285	20,000	For elderly homeowners: Variable threshold. (Credit equals taxes that exceed 1%-2.5% of income.)
Michigan	1,200	223	none	For non-elderly homeowners: Simple threshold with co-insurance feature. (Credit equals 60% of taxes that exceed 3.5% of income.) For elderly homeowners: Variable threshold. (credit equals taxes that exceed various percentages of income.)
Minnesota	800	157	none	Variable threshold with sliding maximum credit. (Credit equals taxes that exceed 0.5%-4% of income. Maximum credit ranges from $475 with income below $3,000 to $325 with income of $100,000 or more. Additional adjustments for senior and non-senior homeowners with total refund not to exceed $800.)
New York	200	NA	12,000	Variable threshold with co-insurance feature and sliding maximum credit. (Credit equals 50% of taxes that exceed 4-7% of income. Maximum credit ranges from $10 to $200.)
Oregon	655	148	15,999	Variable credit

Table 5. Circuit breaker programs in 30 states: 1978 (continued)

Coverage (2)	Maximum benefit	Average benefit (3)	Maximum income	Type of relief formula (4)
All homeowners and renters (cont'd)				
Vermont	$500	$210	None	Variable threshold. (Credit for t exceeding 4%-6% of income.)
Wisconsin	640	206	9,300	Variable threshold with co-insuran feature. Credit for 80% of taxes income is under $400; if income i over $4,000, credit for 80% of ta exceeding 15% of income.
All homeowners				
Maryland	900	248	none	Variable threshold. (Credit for ta exceeding 1.5% to 9% of income.)

Legend:

(s) single homeowner,except in South Dakota, single-member household.

(m) married homeowner, except in South Dakota, multi-member household.

NA Data not available.

BAV Based on assessed value.

Notes:

(1) ACIR identified 31 states with circuit breaker programs in 1978. However, Hawai provided benefits only to renters and is not included in the above table.

(2) A total of 12 states in 1978 extended circuit breaker coverage to the disabled. In addition, some of the 12 states also extended coverage to one or more of the followin groups: blind, widows or widowers, fatherless children under 18, and disabled veterans.

(3) Average benefits are reported for one of the four years from 1976 and 1979, and may be estimates.

(4) In four states, relief is provided by reducing tax bill directly; in all others, relief takes form of tax credit or rebate.

Source: ACIR, Significant Features of Fiscal Federalism, 1978-79 Edition, p. 63-68.

In brief, the threshold approach would seem to be the most direct way of meeting the objective of providing relief when property taxes are excessive in relation to income. For example, a program can be designed to meet precisely whatever the goal may be, such as rebating property taxes in excess of 5% of income at the $6,000 level. Thus, two homeowners with $6,000 income would pay exactly the same percentage of income for property taxes (5%, or $300) even if one had a tax bill of $400 and the other, a tax bill of $700.

However, the proponents of the sliding scale approach believe that the threshold approach is inequitable, and prefer their formula whereby each homeowner in the above example receives a uniform percentage rebate, for example, 50% of taxes paid. In this way, the $6,000 income homeowner with higher gross taxes, and presumably the more valuable home, would still pay higher taxes after the rebate, as summarized below.

Gross tax	Rebate		Net tax	
	5% Threshold	50% Rebate	5% Threshold	50% Rebate
$400	$300	$200	$100	$200
$700	$300	$350	$400	$350

Another advantage claimed for the sliding scale approach is that the taxpayer always pays a percentage of the tax ("coinsurance") when taxes go up, while under the threshold formula, the homeowner is immune to tax increases. However, some threshold formulas rebate only a percentage (e.g. 80%) of the tax in excess of the threshold, and thereby incorporate the coinsurance feature.

Maximum Benefits

All circuit breaker formulas put a ceiling on benefits. According to Gold,

> "Under most circuit breaker formulas only a small number of recipients are affected by the maximum benefit level. But a maximum is important to prevent large payments in unusual cases."*

Table 5 lists the maximum benefits of state circuit breaker programs in effect in 1978. The range was $125 to $1,200. Typically, the maximum was in the $400 to $600 range. This is not enough to provide substantial relief for the Philadelphia taxpayer in our model in Chapter II--the homeowner in the $4,000 to $6,000 income range with a gross tax bill of $800 to $1,200.

Eligibility Criteria

Eligibility criteria for circuit breakers of other states may also be compared to the Pennsylvania plan. As to age, Pennsylvania's circuit breaker is generally available only to those age 65 or over, except for the disabled of any age and for widows and widowers over age 50. Of the 29 states, 22 also set age requirements for participation.

The most common reason cited for having the program only for elderly or

*Gold, p. 65.

disabled is that such persons may permanently have low incomes in relation to housing values, because of reduction of income after retirement, and therefore have permanent need for relief. Younger persons may temporarily be unable to pay property taxes, because of unemployment or illness, but would generally not have a permanent reduction in income. Also, programs limited to the elderly are less costly than programs without such limits.

Pennsylvania's circuit breaker limits benefits to those with incomes under $12,000. In 1978, the maximum income range in other states was $3,750 to $20,000, with the median $8,000. Four states did not have a maximum income limit. These had variable threshold formulas, and gave benefits for taxes in excess of the threshold regardless of income, but subject to a maximum benefit ranging up to $1,200.

The great majority of the 30 states with circuit breakers give benefits to renters as well as to homeowners. In most formulas, some percentage of the rent is considered equal to the property tax paid by homeowners and is used to calculate a tenant's circuit breaker benefit. In 1978, the percentage of rent considered equal to the property tax varied from 6% of gross rent in New Mexico to 25% of rent in several states. (Pennsylvania uses 20% as the figure.)

Comparisons of Application to the Model Aged Homeowner

Table 6 compares how Pennsylvania's circuit breaker program and the programs of some other states would aid the family discussed earlier: the homeowner with gross tax bill (before relief) of $1,200 and income in the range of $4,000 to $12,000. In addition to Pennsylvania's sliding scale circuit breaker, the table shows Orgeon's "variable credit", Ohio's "variable reduction in assessed value", California's "sliding scale", and "variable threshold" programs of Maryland and Michigan.

At the $4,000 income level, the lowest net tax bill is still more than 11% of income, with a range of 11.3% to 21.5%. At the $6,000 level, the net tax bill would range from 7.5% of income to 17.8% of income.

The greatest relief in each case is provided under the Maryland variable threshold program; this is followed by the Michigan program. Theoretically, a variable threshold program could be designed so that taxes do not exceed a target percentage of income. In practice, there is a benefit ceiling.

To provide substantial relief to homeowners with very high property taxes in relation to income as in our illustration, variable threshold circuit breakers such as those of Maryland and Michigan would require higher maximum benefits--which would make the programs more costly. Michigan sets its percentage-of-income threshold at a lower level than does Maryland. But since Maryland's maximum benefit is higher, its formula provides more relief in our illustration. It should be noted that Michigan keeps its costs down by using a dual formula that provides non-elderly homeowners with lower benefits than elderly homeowners. Maryland's program applies equally to all homeowners.

Table 6. Real estate tax bill as a percentage of household income for homeowner with $60,000 market value home, at three income levels, under Pennsylvania and other states' circuit breaker (gross tax: $1,200)

Type of formula (1)	State	Maximum benefit	Tax bill as % of income for owner of $60,000 home		
			$4,000 income	$6,000 income	$12,000 income
Sliding Scale	Pennsylvania	$500	17.5%	11.7%	10.0%
Variable credit	Oregon	$490 (2)	21.0	15.4	9.2
Variable reduction (3) in assessed value	Ohio	Maximum reduction in A.V. is lesser of $5,000 or 70%	21.5	16.6	10.0
Sliding Scale	California	Maximum A.V. (3) used to compute credit: $7,500	21.1	17.8	10.0
Variable threshold	Michigan (4)	$500	17.5	11.7	5.8
	Maryland	$750	11.3	7.5	5.0

(1) Formulas are derived from literature search and are not necessarily current. Pennsylvania formula is current through 1982; Oregon, 1976; Ohio, 1974; California, 1976; Michigan, 1974, and Maryland, 1976.

(2) Under variable credit circuit breakers, relief is stated in dollars. Maximum applies only to the lowest income level.

(3) This table assumes an assessment ratio of 29.63%, the average for residential property in Philadelphia in 1978. As noted in the text, assuming a single assessment ratio for all property owners is an unrealistic assumption. Effective assessment ratios vary both within and among jurisdictions; formulas that base relief on assessed values are likely to foster inequities.

(4) Michigan uses a dual formula for the elderly and non-elderly. The formula applied here is the one applicable to the elderly, the more generous of the two.

Homestead Exemptions and Homestead Credits

Homestead exemption or homestead credit programs are even more prevalent than circuit breaker programs. In 1979, 38 states and the District of Columbia had homestead exemption or homestead credit programs--at least 15 of these states also had circuit breakers.

> A homestead exemption excludes a portion of a property's assessed value from taxation. The exemption is normally financed (that is, lost revenues are made up) at the local level of government. A few state governments reimburse their local governments for the lost revenues.
>
> A homestead credit is a reimbursement or credit for all or part of the real estate tax. The credit is almost always financed by the state. The credit may be computed as (a) a flat amount, (b) the tax on a stated amount of assessed value, or (c) a percentage of the tax. A homestead credit differs from a circuit breaker benefit, in that the homestead credits do not vary with income.

A brief summary of the homestead exemption programs is shown in Table 7. The majority of states with homestead exemptions either limit the program to elderly, or give the elderly preferential treatment. Many of the states also place a maximum income limit--ranging from $3,000 to $7,500--for participation in the program. The amount of assessed value exemption ranges from $1,000 to $30,000. But as Gold notes, "there is no sense in comparing the amounts of assessed value which are exempted, because assessment practices vary widely."*

The homestead credit, like the circuit breaker, is a form of tax relief that is designed to enable states to assume the financial burden of property tax relief. But many credits closely resemble homstead exemptions in that credit or rebate equals the tax on some portion of assessed valuation. For example, Tennessee's homestead credit was equal to a reduction in assessed valuation of $5,000 (and was applicable to elderly homeowners with a maximum income of $4,800).

Another type of homestead credit is a flat dollar amount. This eliminates the inequities that often result when tax relief is based on assessed valuations, which often vary widely in and among jurisdictions. In New Jersey, for instance, a senior citizen with an annual income of $5,000 or less (excluding social security) is provided with a $160 deduction on the tax on his residence.**

In the 1970's, the percentage credit was introduced by Minnesota. Until 1979 when the formula was revised, this credit paid 45 percent of the homeowners' tax bill up to a maximum of $325. In the same year, similar programs were enacted by Utah, Oregon, Wisconsin and Indiana.***

Property tax relief formulas under homestead exemptions or credits do not permit as precise targeting of relief by income categories as do circuit breaker

*Gold, p. 84.

**Commerce Clearing House, Inc., 1979 Guidebook to New Jersey Taxes (Chicago, 1979), p. 202.

***Gold, p.82.

Table 7. Principal state and local homestead exemption programs in 25 states: 1976

State	Maximum income	Assessed value reduction
Elderly Homeowners		
Alabama(2)	$5,000 or none	100% or $5,000 (state ad volorem) (3)
Alaska	none	N.A.
Delaware(4)	$3,000	$5,000
Florida(2)	none	$10,000
Georgia(2)	$4,000	$4,000
Hawaii(1)	none	$24,000-$30,000
Illinois	none	$1,500 (max.)
Indiana	$6,000	$1,000
Kentucky	none	$6,500
Massachusetts	$7,000 (m)	$4,000 (or $3,500, whichever is greater)
Nebraska	$3,550 (m)	90% first 15,000 of av., $250 max.
New Hampshire	$6,000 (m)	$5,000 (max.)
New York	$6,000 (0)	50%
North Carolina	$7,500	$5,000
Rhode Island	$4,000	N.A.
South Carolina	none	$10,000
South Dakota	$4,000 (m)	$1,000
Texas	none	$3,000
Washington	$4,000	$5,000
West Virginia	none	$5,000
Wyoming	$6,000 (m)	$1,000
All Homeowners		
Alabama(2)	none	$2,000 (state ad valorem)(3)
California	none	$1,750
Florida(2)	none	$5,000 (school district)
Georgia(2)	none	$2,000
Hawaii(2)	none	$12,000
Louisiana	none	$2,000
Mississippi	none	$5,000
Nebraska	none	N.A.
Oklahoma	none	$1,000

(m) Maximum income shown is for married homeowners; single homeowners use lower maximum.
(o) In New York, the state-mandated income ceiling is $3,000, but this may be raised to $6,000 by locality.
NA Not available.
(1) In Hawaii, homeowners between ages 65 and 69 receive $24,000 exemption; homeowners 70 and over receive $30,000 exemption.
(2) Alabama, Florida, Georgia and Hawaii have separate programs for elderly and non-elderly and are shown twice in above table.
(3) In addition to total exemption from property taxes for elderly with maximum income of $5,000, Alabama provides all elderly homeowners 65 and over, regardless of income, with a $5,000 exemption from state ad valorem taxes. Homeowners under age 65 receive a $2,000 exemption from state ad volorem taxes.
(4) Delaware's exemption is mandated for state or county property taxes, but optional for municipal property taxes.

Source: ACIR, Significant Features of Fiscal Federalism, 1976-77, pp. 109-116.

formulas. Also, homestead exemptions and credits provide benefits to all who qualify (by age or income) and thus are more costly than circuit breaker programs limited to those with excessive property taxes in relation to income.

Rationale for Exemptions and Credits

The following are some of the reasons cited for the use of homestead exemptions and credits.

Reduce regressivity of the property tax: A major criticism of the property tax is that the tax is regressive, that is, the tax equals a higher percentage of income for poor persons than for wealthy persons. (Some argue that the property tax is not regressive, but is proportional or even progressive. See Appendix B. In any event, a homestead exemption or credit is a flat amount, and thus the relief is a higher percentage of low income than of high income. The exemption or credit would therefore make the tax less regressive or more progressive, according to one school of thought). The progressivity of a homestead credit or exemption can be increased if the benefits are limited to low income elderly.

Shift burden of property taxation: By excluding some portions of residential assessments from taxation, government must look to the non-residential property owners to pay a higher proportion of tax revenues. Of course, others would oppose exemptions for the very reason that they are a roundabout way of achieving a "classified" property tax, with higher taxation of business and industry than residences.

Appear to benefit all homeowners: Some argue for exemptions and credits as the most politically attractive way to give relief to low income homeowners, since many of such programs give some benefits to all homeowners.

However, critics point out that actually a homestead exemption program may shift the tax burden to homeowners with higher property values. This is because the loss of revenue will normally be made up by raising the property tax rate for all homeowners. For those with low property values, the amount of the exemption would more than offset the increase in the tax rate, but as property values go up, the exemption becomes a smaller portion of the total value, and the increased tax rate will at some point exceed the value of the exemption.

Do not require cost accounting procedures: Homestead exemptions are, in effect, "tax expenditures" and as such do not require the budgeting and accounting procedures of regular expenditures. While many would find this a disadvantage, some argue that this makes homestead exemptions politically more acceptable than forms of government assistance which require direct budgeting of expenditures.

Application to the Model Problem

As noted above, some 15 states provide property tax relief by a combination of a circuit breaker and an exemption or credit. In all of these states,

benefits under the credit or exemption are available to all homeowners, regardless of age or income. According to Gold, such an approach enables the states to "provide some benefits to everyone while giving extra relief to certain targeted groups of taxpayers."*

To demonstrate how a combination plan might work in Pennsylvania, Table 8 shows the impact upon our model homeowner, with a $60,000 value home, gross tax $1,200, and income in the range of $4,000 to $12,000. As shown in Chapter I, before any property tax relief, the tax burden ranges from 10% of income at the $12,000 income level to 30% of income at the $4,000 level.

Table 8 compares the benefits available under Pennsylvania's circuit breaker with the following:

(1) combination of Pennsylvania circuit breaker and a $3,000 homestead exemption for elderly,

(2) combination of Pennsylvania circuit breaker and a $6,000 homestead exemption for elderly,

(3) combination of Pennsylvania circuit breaker and a homestead credit, equalling 45% of the gross tax.

The table is fairly easy to read. Line 1 shows that the Pennsylvania circuit breaker would reduce the tax burden to 17.5% at the $4,000 income level and to 11.7% at the $6,000 level--both still much higher than most would consider acceptable.

At the $4,000 income level, line 2 shows that attaching a $3,000 exemption reduces the tax burden to 12.5% of income; and line 3 shows, with a $6,000 exemption, reduction to 7.4% of income. The model credit shown in line 4 would reduce the burden to 9.4%.

At the $6,000 income level and the $12,000 income level, the exemptions tested would reduce the tax burden to the 4.9% to 8.3% of income range.

Of course, if the exemptions were higher, the relief would be even greater.

Thus, the table indicates that substantial property tax relief for low income homeowners could be achieved by a combination circuit breaker and exemption program. But it would be a costly way to achieve such relief for persons with low income and high property values, since benefits would be provided under the exemption to many who did not need them. Thus, the homestead exemption or credit has been called a "shotgun" approach, compared to the fine tuning which can be achieved by a circuit breaker. Moreover, there may be other possible remedies which are reviewed in the following sections.

*Gold, p. 90.

Table 8. Net property taxes for elderly owner of $60,000 home and gross tax bill of $1,200 as percentage of income at three levels, under the Pennsylvania circuit breaker and several combinations of circuit breaker and homestead exemption or credit: 1982

	$4,000 Income		$6,000 Income		$12,000 Income	
	Net tax	% of inc.	Net tax	% of inc.	Net tax	% of inc.
1. Pennsylvania circuit breaker	$700	17.5	$700	11.7	$1,200	10.0%
2. Pennsylvania circuit breaker plus $3,000 homestead exemption on assessed value	498	12.5	498	8.3	998	8.3
3. Pennsylvania circuit breaker plus $6,000 homestead exemption on assessed value	295	7.4	295	4.9	795	6.6
4. Pennsylvania circuit breaker plus a homestead credit equal to 45% of gross tax with a maximum homestead credit of $325	375	9.4	375	6.3	875	7.3

Note: The table assumes an effective tax rate of 2.0% of market value (Philadelphia's tax of 67.5 mills and an assessment ratio of .2963). The assessed value under these assumptions would be $17,778, and the gross tax would be $1,200. Tax rates were raised in May 1982, effective for the Fiscal 1983 year.

Property Tax Deferral

Whereas the property tax relief mechanisms discussed previously in this chapter "forgive" all or part of a homeowner's tax liability, deferral programs provide a mechanism that enables eligible homeowners to "postpone" payment of property taxes until some later date.

The government jurisdiction granting the deferral protects its interest in the deferred taxes by placing a lien on the home of the participant. The deferred taxes may then be legally collected when the property is later sold, either by the participant or his estate.

The first tax deferral program was enacted by Oregon in 1965 as part of an overall "relief" package that included a homestead exemption. By 1980, ten states plus the District of Columbia had deferral programs.* (See Table 9.)

Rationale for Deferral

Some analysts argue that traditional property tax relief mechanisms, particularly the circuit breaker, measure only one aspect of a homeowner's wealth: current income. It is not unusual, however, for a homeowner to have a low current income but a relatively high net worth. The elderly, in particular, tend to fall into this category.**

When wealth consists primarily of assets, as opposed to current income, future or imputed income is "locked in" to the value of the asset. Unlocking that future income requires that the asset be sold or that a loan be made on the value of the asset. The loan could be repaid at some future date when current income increases or when the asset is sold.

This type of thinking is traditionally employed by businesses facing a cash flow problem; however, few property owners think of their homes in such raw economic terms. Nothing that has taken place in the past decade and a half suggests that the following statement has lost its relevance:

> This plan (deferral) would, however, require a fundamental reexamination of the role of a home as an asset which may be liquidated to produce current income for purposes such as taxes, living expenses, medical care, gifts and travel. The institutions necessary for this type of financial operation--both private and government organizations in the housing market--are already in existence. If private enterprise can and will provide this service, no government participation will be needed. If private enterprise cannot or will not do it alone, the government may offer guaranteeing functions. If private enterprise will not engage in such an operation, however, the role of government may be one of direct lending.***

*A summary of tax deferral programs is found in Steven D. Gold, "Homeowner Property Taxes, Inflation and Property Tax Relief," National Tax Journal (Vol. XXIV, No. 2, June 1981), p. 180-181.

**Yung-Ping Chen, "Property Tax Concession to the Aged," in Property Taxation USA, Linholm, Ed. (Madison: University of Wisconsin Press, 1964), pp. 230-231.

***Ibid, p. 232.

Table 9. Key features of state and local property tax deferral programs and the use of deferral in conjunction with other property tax relief programs: 1980

State	Date of inception	State mandated or optional for local government	Minimum age for participation	Income limit	Other property tax relief programs for the elderly: Circuit breaker	Homestead exemption	Tax freeze
California	1977	mandatory(a)	62	$30,700(b)	yes	yes	no
Colorado	1979	mandatory	65	none	yes	no	no
Dist of Col.	1977	--	none	20,000	yes	yes	no
Florida	1978	mandatory	none	none	no	yes	no
Massachusetts	1974	mandatory	65	20,000	no	yes	no
Oregon	1963	mandatory(a)	62	none	yes	yes	no
Tennessee	1980	optional	65	12,000	no	7es	no
Texas	1971	mandatory	65	none	no	yes (optional)	no (school dist.)
Utah	Before 1975	optional	65	7,500-single 8,000-married	yes	yes	no
Virginia	Before 1975	optional	65	Varies: 15,000-18,000	no	yes	yes (optional)
Washington	1975	n.a.	61	12,320(b)	no	yes	no

(a) California and Oregon reimburse local government for revenues losses from deferral and, when collected, the deferred taxes are paid to the state. The other states do not reimburse the local governments for revenue losses.

(b) Indexed to Consumer Price Index.

Sources: Stephen D. Gold, Property Tax Relief (Lexington, Mass.: Lexington Books, 1979), p. 57, 83, 85 and 86; and Stephen D. Gold, "Homeowner Property Taxes, Inflation and Property Tax Relief," National Tax Journal, (Vol. XXIV, No. 2, June 1981), p. 180-181; also, Telephone information from Texas Research League,' District of Columbia Department of Finance, and Massachusetts Taxpayers Foundation.

The fact that deferral--whether financed by private financial institutions or government--is fundamentally a loan secured by deed or title to a person's home would suggest that deferral has certain built-in restrictions basic to any loan process. For instance, deferral of taxes as a means of providing property tax relief would obviously not work well in situations where there is little prospect that the loan would be repaid in a reasonable number of years. *

Design of Tax Deferral Programs

Some of the issues in the design of tax deferral programs are reviewed below. Characteristics of various programs are shown in Table 10.

Interest rate: One key issue is the interest rate, if any, to be charged on deferred taxes. Some programs have no interest charges, others do. For example, the Massachusetts program has an 8% interest charge; the Oregon program, a 6% charge.

If no interest is charged, or the interest rate is too low, it is conceivable that a homeowner who could afford to pay taxes currently might decide to defer taxes and make a profit by investing the money at higher interest rates.

Relationship to home equity: The relationship of total deferred taxes to the equity in the home would have to be ascertained, if it is desired that the loan does not exceed the owner's equity. The Massachusetts program provides that the total deferral taxes plus interest may not exceed 50% of the owner's equity in the property.

Financing revenue loss: For some years after a deferral program is started, the local governments are likely to have revenue losses. Eventually, the payment of deferred taxes upon sale of the properties is likely to equal losses from deferments. California and Oregon provided for state financing of the lost revenues. Massachusetts gave local governments the option of issuing 3 year bonds to finance program start-up costs.

Income limits: Some state programs have no income limits, while others have such limits. Examples are $20,000 in Massachusetts, $4,000 in Utah, and $10,000 in Virginia.

Age limits: Most deferral programs are limited to the aged. However, many advocates of deferral believe that programs should be available for all ages, especially for those who suffer temporary declines in income. For example, Aaron believes that the eligibility for deferral should be extended to all homeowners whose property taxes exceeded some predetermined percentage of income.** The District of Columbia program is available for all ages.

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*Ibid. p.232.

**Henry J. Aaron, Who Pays the Property Tax, A New View (Washington D.C.: the Brookings Institution, 1975), p. 79.

Table 10. Financial characteristics of state and local property tax deferral programs: 1979

State	Amount of tax deferable	Interest rate	Number of participants	Total taxes deferred	Average taxes deferred
California	All	7%	9,700	$3,200,000	$330
Colorado	All	8%	26	16,390	630
Dist. of Col.	Increased taxes over 10% due to reassessment	Avg. Treasury bill rate in previous year	3	Less than 1,000	Less than $333
Florida	Tax in excess of(a) 5% of income	Avg. yield of investments of state pension fund	7	n.a.	n.a.
Massachusetts	Up to 50% of assessed value	8%	553	721,000	1,303
Oregon	All	6%	4,196	2,600,000	620
Tennessee	Tax increase after age 65	10%	n.a.	n.a.	n.a
Texas	All	6% annual plus one-time 8% penalty	"rarely used"	n.a.	n.a.
Utah	All	8%	very few	n.a.	n.a.
Virginia	Up to 100% (local option)	Local option	n.a.	n.a.	n.a.
Washington	Up to 80% of owner's equity	8%	50 (approx.)	10,000 (approx.)	200 (approx.)

(a) Total amount of deferral may not exceed 85% of assessed value.

Source: Stephen D. Gold, "Homeowner Property Taxes, Inflation and Property Tax Relief," _National Tax Journal_, (Vol. XXIX, No. 2, June 1981), p. 180-181.

Participation

Available data suggest that participation in most deferral programs is extremely low.* Tax administrators interviewed by Abt Associates suggested two major reasons: reluctance to assume indebtedness, and misinformation. Apparently, many elderly are unwilling to encumber their estates, or pass on financial obligations to their heirs.

The Massachusetts tax deferral program had 553 exemptions granted in 1979 and 521 in 1980; tax dollars abated were about $700,000 in both years.**

Application to the Model

The prior sections have provided illustrations as to how circuit breakers and homestead exemptions would aid the family used as model to test various programs: the Philadelphia homeowner with a home valued at $60,000, a gross tax bill of $1,200 but income in the range of $4,000 to $12,000. It was pointed out that the tax bill would still be more than 10% of income under many of the programs reviewed.

A tax deferral program could be devised to permit eligible taxpayers to defer either all of the tax liability in excess of the circuit breaker benefits, or tax liability which exceeded some threshold percentage of income, for example, 5% of income. The advantage of a tax deferral as a property tax relief program is that it prevents hardship to elderly but does not permanently reduce governmental revenue, since there is a very high probability that the government will be able to recoup the deferred taxes.

It is assumed that the elderly homeowner who applies for tax deferral owns the home free and clear (as is the case with most elderly homeowners) or at least has a substantial equity in the home. If deferral continued for many years, it is possible that the deferred taxes could exceed the value of the home, but that would appear to be very unlikely, unless the home's value decreased over time.

Table 11 gives illustrations of the amounts which might be involved in tax deferral programs for model homeowners in the $4,000 to $12,000 income range, and with homes valued at $40,000 or $60,000. Even if total taxes were deferred for 20 years, the accumulated amounts deferred would be less than half of the home's value in the illustration. And if the deferral program applies only to the portion of the tax which exceeded 5% of income, the accumulated deferral would be an even smaller fraction of house value. Thus, even if longevity were extended to 30 or 40 years, it is unlikely that the accumulated taxes would exceed the home value.

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*See Table 10.

**Memorandum to Edward J. Collins, Jr., Deputy Commissioner, Re: Chapter 59, Section 5, recapitulating exemptions granted by cities and towns.

Table 11. Illustrations of property tax deferral for elderly to supplement the Pennsylvania "circuit breaker": 1982

Annual income	Gross Tax	Circuit breaker benefit*	Net tax	Total deferment--assuming taxes deferred for 15 years**: All net taxes deferred	Total deferment--assuming taxes deferred for 15 years**: Net taxes in excess of 5% of income deferred
A. $40,000 home					
$ 4,000	$ 800	$625	$175	$2,625	none
$ 6,000	800	555	245	3,675	none
$12,000	800	none	800	12,000	3,000
B. $60,000 home					
$ 4,000	1,200	$625	575	8,625	5,625
$ 6,000	1,200	555	645	9,675	5,175
$ 12,000	1,200	none	1,200	18,000	9,000

*Including "inflation dividend."

**Assumes interest on deferred amount is not required.

Tax Freeze for Elderly

The tax freeze is a relatively simple concept, under which taxes for elderly are "frozen" at a base year level, generally the year in which the homeowner turns 65.

Only a few states utilize this approach. According to Gold, as of 1979 Connecticut had a state-administered freeze; Rhode Island and Virginia permitted local government to have tax freezes; and Arkansas enacted one in 1979 (not specified as to state or local administered). Formerly, Minnesota had a tax freeze for elderly, but this was eliminated in 1977.*

There are some variations in the programs as to income limits and which level of government finances the program.

Connecticut's program has a $6,000 income limit; Minnesota's program (terminated in 1977) had no income limit. The local option programs in Rhode Island have a $7,000 maximum income limit; Virginia's guidelines for its local option programs include a $10,000 maximum income limit.

As to financing, under the Connecticut program, the state reimburses each locality for taxes foregone as a result of the freeze. Under Minnesota's program, the claimant had to pay his property tax in full, and then received a credit on the state income tax for the difference between the base year tax and the current tax. If the claimant had no income tax liability, the state paid the rebate directly.

Rationale for Tax Freeze

The main argument for a tax freeze for elderly is that it protects homeowners from rising real estate taxes after retirement. The presumption is that much of the problem of high property taxes in relation to income is caused by post retirement tax increases. It is assumed that during his working years the homeowner has anticipated a fairly stable property tax level in planning for retirement, and will be able "to make it" financially if not faced with rising property taxes.

It is also argued that a tax freeze is relatively simple to administer, and that it is less costly than some alternative property tax relief measures.

There are also arguments against the tax freeze. One is that a tax freeze may not provide sufficient relief for a homeowner whose problem is occasioned not by an increase in taxes, but by a drastic cut in income upon retirement (and an even greater cut income if the spouse's pension is terminated upon death). Moreover, a tax freeze may not target relief to those who really have excessive

*Gold, Property Tax Relief, p. 85. A more extensive description of the Connecticut and Minnesota programs, and of the optional guidelines applying in Rhode Island and Virgina, is in Abt Associates, Compendium Report, p. 95-103.

property taxes in relation to income; it may be used by all elderly within the income limits specified. Also, some of the elderly who are eligible for a tax freeze are "property rich" but "income poor." It would be desirable to meet their problem by a tax deferral program, rather than by a tax freeze which causes permanent loss of revenue to government.

Coordination with Circuit Breaker

If a state also has a circuit breaker program, how should the freeze and the circuit breaker be coordinated? Connecticut provides that a homeowner can participate only in one or the other program. Minnesota had a similar provision. Information is not readily available on the local option programs in Rhode Island, which did not have a state circuit breaker when the local option freeze program was initiated. The other local option state--Virginia--does not have a circuit breaker program.

Application to the Model

A number of assumptions must be made to apply the tax freeze to the "model" Philadelphia taxpayer with a $60,000 house, a $1,200 tax bill, and income in the $4,000 to $12,000 range. If the house value had increased greatly after retirement (e.g. from $30,000 to $60,000), then tax freeze would cut taxes in half and thereby provide substantial relief. However, if this is not the case, and the home had increased greatly in value before retirement, a tax freeze would not be very helpful, inasmuch as the homeowner would be liable for taxes on the $30,000 increase in the value of the home.

IV. REVIEW OF RECENT PROPOSALS FOR PROPERTY TAX RELIEF IN PENNSYLVANIA

This chapter reviews property tax relief proposals made at the state level in Pennsylvania, and then turns to proposals made in Philadelphia.

Proposals at the State Level

Proposals have been made by the Pennsylvania Tax Commission; also a number of bills have been introduced in the 1981 legislative session.

Report of the Tax Commission

In March 1981, the Pennsylvania Tax Commission completed 17 months of study on the state and local tax structure in Pennsylvania. The commission's 99-page report contains numerous recommendations.*

The commission's proposals were made within the framework of the Governor's charge not to recommend increases in taxes for the state's general fund. Thus, any recommendations had to be feasible within revenue projections. The commission reviewed evidence that the property tax was regressive before enactment of the Pennsylvania circuit breaker (described in Chapter II), but that the circuit breaker makes improvements up to the $7,000 income level. "However, for families with incomes between $7,000 and $13,000, the rebate program fails to stabilize or reduce the regressivity of the property tax."**

The commission examined various alternative extensions of the circuit breaker program. It recommended extending the upper income limit of the program from $9,000 to $12,000, and providing for a rebate of 10% of property taxes for the elderly in the newly covered $9,000 to $12,000 income range. The commission also recommended some increases in the percentage of tax rebated for elderly with incomes under $9,000. The proposal was estimated to raise the cost of the rebate program by $10 million, or 9%, and extend the program to an additional 143,000 households--an increase of 22%.

Bills Introduced in the 1981 Legislative Session

A number of bills were introduced in the 1981 session of the General Assembly dealing with various aspects of property tax relief for the elderly. These include proposals for homestead exemptions, real estate tax freeze, and other real estate tax reductions.***

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* Pennsylvania Tax Commission (Richard M. Cyert, Chairman), Final Report of the Pennsylvania Tax Commission, March 1981.

** Ibid., p. 26.

*** As of May 1982, the bills had not been passed, and it seemed likely that they would "die."

Property tax exemptions. A number of bills patterned after homestead exemptions in other states would exempt all or part of the assessed value of homes of elderly from taxation. The tabulation below summarizes the main features.

Amount exempted	Income limit	Bill
$10,000	$10,000	House 171
$5,000	none	House 211
100%	none	House 485
Percentage relates to income as in state circuit breaker		House 193 and 194
1/2 of assessed value for school taxes	$12,000	Senate 115
Local option	$ 9,000	House 780 through 791

It was noted in the Chapter III discussion of homestead exemptions in other states, that a program of homestead exemptions--if the exemption was high enough--could meet the problem of the model homeowner who had low income but high property value. However, a homestead exemption program would be an expensive remedy for the problem.

Property tax deferral. Three bills proposed property tax deferral programs for Pennsylvania. House Bill 166 would permit deferral of tax increases after age 62, for persons with an annual income of less than $12,000. No deferrals may be granted if the total amount of deferred taxes plus other unsatisfied liens exceeds 85% of market value. No interest would be charged.

House Bill 445 is similar, but provides for deferral for homeowners age 65 or older.

Senate Bill 275 would set eligibility at age 62, and establish a maximum income for participation at $15,000.

It is notable that each of these bills would provide for deferral only for increases after the householder reached eligibility age. Thus, it is difficult to evaluate the impact of such bills on the problem of our model household with low income and relatively high housing value. If the house value in the model increased greatly after the householder became a senior citizen, a program of deferral of tax increases would be very helpful in meeting the problem. However, if the house escalated in value prior to the owner reaching retirement age, deferral of increases in taxes would not meet the problem.

Assessment freeze. House Bill 919 would protect homeowners from increases in taxes because of rising property values after retirement. It would freeze assessments for homeowners age 65 (or widows age 55) if income does not exceed $10,000.

Governor's Program

In November 1981 the Governor proposed to raise the upper income limit for the circuit breaker to $12,000 (as recommended by the Tax Commission), and increase the maximum rebate from $400 to $500. The proposal also increased the "inflation dividend" under the Older Pennsylvanians Inflation Needs program by raising the minimum grant from $15 to $30 and the maximum grant from $95 to $125. Thus, the combined maximum property tax rebate and inflation dividend was increased from $495 to $625. The proposal became Act 56 of 1982.

Proposals by Philadelphia City Council

Although no specific enabling legislation has been passed by the state permitting local programs of property tax relief for needy citizens, bills were introduced in Philadelphia City Council that would provide some relief within the framework of existing law.

Bill No. 495, introduced in December 1980, had the aim of permitting eligible taxpayers to defer that part of their liability resulting from increases in assessments or tax rates. The bill would authorize the city Revenue Department to waive interest and penalties on the unpaid taxes. Administrative procedures would then be established so that the unpaid taxes would be liened against the property, but no execution would take place until title was transferred. Eligibility would be restricted to those eligible for the state circuit breaker (aged, widowed, disabled) who meet the upper income limits set by the federal government for its Section 8 housing program. (For example, in 1980, the upper limits were $11,800 for a single person and $13,500 for a two-person family.) The bill never had a hearing.

An alternative standard was embodied in Bill No. 520 (introduced January 1981) which in effect would permit deferral of taxes exceeding a threshold of 5% of income. Eligibility for deferral is limited to elderly who meet the same income standards as in Bill No. 495. The bill would authorize eligible taxpayers to enter into installment agreements with the city Revenue Department for paying real estate taxes; no installment agreement would, without the taxpayer's consent, require payment of more than 5% of household income. Presumably, the intent is that taxes in excess of 5% of income be deferred. The Revenue Department would waive interest and penalties on unpaid taxes and would not execute on the liens for unpaid taxes while the taxpayer was meeting installment payment obligations. The bill never had a hearing.

In 1982, ordinances were enacted authorizing installment payment agreements with low-income taxpayers and senior citizens (age 65 and over) with low incomes.*

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* Bill No. 1160, signed by the mayor April 14, 1982, adding section 19-1305 to the Philadelphia Code, as amended by bill No. 1222, effective May 27, 1982.

Low income for the purpose of the ordinance ranges from a maximum of $15,000 for a one-person household to $24,200 for a 10-person household. These limits apply to 1981 income, and are to be adjusted upward annually by an amount equal to three quarters of the increase in the consumer price index.

For all low-income taxpayers, the ordinance authorizes installment agreements for payment of real estate taxes, and waives additions, interest, and penalties otherwise due if the taxpayer successfully completes an installment agreement by the end of the calendar year.

For low-income senior citizens, installment agreements may extend beyond December 31 of the year. The senior citizen must acknowledge in writing that he or she understands that an agreement for a term extending beyond December 31 will "jeopardize entitlement to the Pennsylvania Senior Citizen Real Property Rebate and result in a lien against the household."

While not providing a permanent deferral of taxes for senior citizens, the ordinance does permit extending the payment over more than one year. This could help reduce hardship if substantial rise in assessment increases the property tax bill greatly.

V. SUMMARY; ADVANTAGES AND LIMITATIONS OF THE VARIOUS PROGRAMS

This chapter reviews the topic addressed in this study--the problem of the Philadelphia homeowner whose real estate taxes are excessive in relation to income. Following a summary of the nature of the problem and of Pennsylvania actions, the chapter reviews alternative actions taken by other states, and presents the pros and cons of such actions.

How High Is Too High?

Chapter I indicated that Philadelphia has about 343,000 owner occupied homes. The average real estate tax liability (before taking into account circuit breaker rebates) is about 2% of market value.* However, because of inadequate assessment practices in Philadelphia, actual tax bills vary greatly in relation to market value.

The Pennsylvania Economy League, in a 1980 report, recommended that the city immediately initiate the reassessment of all real property at a uniform ratio of market value. In a May 1981 agreement, the city administration adopted a goal of moving toward reassessment over a six-year period. The Economy League concludes that accomplishment of the goal at the earliest time possible is essential for an equitable assessment system.

Given an average residential real estate tax of 2% of market value in Philadelphia, the key factor in establishing the ratio of property tax to annual income is the multiple of property value to income. For example, if the property value were equal to income, the property taxes would equal 2% of income; if the property value were five times income, then property taxes would be 10% of income (assuming average assessment ratios).

When is the percentage of income used for property taxes too high? The absolute income level undoubtedly plays a role in whether paying a property tax becomes so burdensome that the family would have to make cutbacks in essential items in the household budget. The Advisory Commission on Intergovernmental Relations suggests that property taxes higher than 4% to 6% of income may be excessive for families in the low to moderate income range.

For this study, it is assumed that when real estate taxes equal more than 10% of income there may be excess burden, and ratios above 6% may also raise questions of excess burden for those in the lower income brackets.

How many Philadelphians pay high property taxes in relation to income? Unfortunately, data are not available in detail, but there are some helpful data in a 1975 housing survey. The median Philadelphia homeowner had a home with a value of 1.5 to 1.9 times income, suggesting an average tax burden in the range of 3% to 4% of income. However, 14% of homeowners had homes valued at four or more times income, suggesting taxes of 8% of income or

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* Based on the 1982 combined city and school tax rate of 6.75% multiplied by the average residential assessment ratio of about 30% to arrive at an effective tax rate of 2% of market value. Real estate taxes were raised for Fiscal 1983.

more. Most of these were in the lowest income groups (incomes under $7,000); the majority were over 64; and most owned their homes free and clear, indicating that they were elderly whose mortgages had been paid off.

Many of these undoubtedly had high tax bills in relation to income. But the tax bill would have been greatly reduced if the homeowner participated in the state's property tax relief program.

Pennsylvania's Action

Pennsylvania provides property tax relief to eligible taxpayers by its circuit breaker law. The term "circuit breaker" was coined to describe programs to protect homeowners from tax overload, by gearing property tax relief to income levels of taxpayers. In addition to Pennsylvania, about 30 other states have circuit breaker programs.

Article VIII of the Pennsylvania Constitution, as amended in 1968, provides the framework for state or local action dealing with property tax relief. The General Assembly may "by law establish as a class or classes of subjects of taxation the property or privileges of persons who, because of age, disability, infirmity or poverty are determined to be in need of tax exemption or special tax provisions."

The state constitution says that if the state law grants real estate tax relief, the state must provide the funding. For local governments to provide additional relief, there has to be state enabling legislation.

The Pennsylvania circuit breaker was enacted in 1971, and has since been broadened by amendments. It is financed entirely from the state lottery.

The circuit breaker is designed to aid certain taxpayers whose incomes are less than $12,000 annually. Eligible are persons age 65 and over, widows and widowers age 50 or older, and the permanently disabled. The maximum rebate is $500.* The rebate varies with the income of the taxpayer, on a sliding scale. The lower the income, the higher the percentage of the property taxes which are rebated.

Examples of the percentage of taxes rebated (always subject to the maximum rebate), are:

Income	Rebate
Under $5,000	100%
$5,000	80
$6,000	60
$7,000	40
$8,000	20
$9,000	10
$12,000 and over	0

Close to 60,000 Philadelphia homeowners received property tax rebates under the circuit breaker for 1979 taxes.

*Excluding the "inflation dividend," which ranges from $125 with income under $5,000 to zero with $12,000 income. Rebates and dividends are also paid to eligible renters.

The average income of the homeowners receiving rebates was $5,096 in 1979; the homeowners reported tax payments, before rebates, equalling 7% of income.

The major limitation of the circuit breaker is that some homeowners, despite receiving a rebate, continue to pay a high percentage of income for property taxes. A major factor is the $500 ceiling. Another factor limiting the relief is the maximum income limit. Finally, the circuit breaker is not designed to meet the needs of those who are not aged, widowed, or disabled. Some of the latter may also pay high property taxes in relation to current income.

No data are available on the number of Philadelphia homeowners with high net tax payments after the rebate. Earlier chapters of this report present some examples of real estate tax liability, assuming an average Philadelphia assessment ratio for households. Homeowners with a $40,000 market value house and $4,000 in income would have a net tax liability of 7.5% or less, if eligible for the state circuit breaker benefits. When market value becomes $60,000, the net tax liability (excluding the inflation dividend) is 17.5% of income.

This combination of low income and high property values (and taxes) is probably infrequent, but there are no data indicating how prevalent the combination is. Such a combination is most likely to occur when property values escalate, and particularly if annual income is reduced by retirement or disability.

Circuit Breakers in Other States

Thirty states, including Pennsylvania, have enacted circuit breaker programs of property tax relief keyed to income. No two programs are identical. Major features are compared in Chapter III. All of the programs place ceilings on the amount of relief, ranging from $125 to $1,200 in 1979. They also differ on income limits for eligibility; the average tended to be lower than Pennsylvania's in 1979.

There is also a basic difference in how relief is granted under the two main variants, the "sliding scale" and the "threshold" approaches.

In general, the sliding scale approach rebates a percentage of the property tax to all eligible taxpayers at a given income level. The percentage rebate decreases, on a sliding scale, as income increases. The rebate is provided regardless of the percentage of income devoted to property taxes. For example, at the $6,000 income level, the Pennsylvania circuit breaker--which uses the sliding scale approach--rebates 60% of the property tax, whether the tax is $100 or $600. However, as noted earlier, the maximum rebate is $500 (plus an inflation dividend).

On the other hand, under the threshold formula, relief is granted only for that portion of the tax bill which exceeds a set percentage of income. For example, if the threshold is set at 5% of income, a $6,000 income homeowner would receive relief only for the tax in excess of $300. Thus, a $6,000

income homeowner with a $100 tax bill would receive no relief; with a $600 tax bill, that homeowner would receive a $300 rebate. All of the threshold programs (like the sliding scale programs) have upper limits on the amount of relief. (In many cases, the threshold varies with income.)

Opinions differ on whether the sliding scale or the threshold is more equitable. While the threshold provides more relief to those who pay high taxes in relation to income, this raises the question of why governmental programs should give more help to those who have chosen to live in more expensive homes. The counterargument is that many of those needing help did not choose to live in expensive homes; property values happened to escalate in their neighborhoods.

Compared to other property tax relief mechanisms (particularly homestead credits or exemptions), the circuit breaker has the advantage of targeting relief to those who need it most--low-income homeowners. However, relief may not be sufficient in some cases to avoid hardship or sale of the home.

Thus, some states have chosen to supplement the circuit breaker.

Revision of the Circuit Breaker

In a "State Bulletin" of August 1981, the Pennsylvania Economy League said:

> A property tax assistance act for the elderly (funded by state lottery receipts) has been in effect since 1971. It has been helpful in mitigating the real estate tax burden on low income elderly families. The income and rebate levels should be reviewed and revised as well as the feasibility studied of extending the act to all low-income families.

The Governor's Tax Commission, in its March 1981 report, recommended that the upper limits be raised.

And in November 1981, the Governor proposed raising the circuit-breaker income limits to $12,000 and the maximum payment to $500. The proposal became law in 1982.

The state circuit breaker meets some of the problems cited in this report, but would not provide relief for all families whose low income is combined with high property values (and high taxes) occasioned by escalating property values in Philadelphia.

There is a question whether owning valuable property with a tax liability far greater than can be met from current income is a problem in which government should intervene. Some might say that the problem, if there is one, is readily solved if the homeowner sells the property, cashes in on the appreciation in value, and moves to a residence more in keeping with income. Others would respond that sale is not a solution; that a long-time homeowner should not be forced out of a neighborhood because of inability to afford rising property taxes; and that some device should be available for property tax relief, so that the long-term homeowner can live out the remainder of his or her years in the old neighborhood.

The Economy League takes no stand on this issue; however, it presents for public consideration a review of measures which have been used in other jurisdictions to supplement the circuit breaker program.

Homestead Exemptions or Credits

Several states have homestead exemptions or credits, generally for the elderly, in addition to circuit breaker programs. The homestead exemption was an early form of property tax relief which preceded the circuit breaker, but was retained in some places when a circuit breaker program was established. The main feature of homestead exemptions and credits is that all homeowners who qualify for aid (based on age or other criteria) receive benefits regardless of income or amount of taxes paid. Using homestead exemptions or credits would be prohibitively expensive to significantly reduce the property tax burden of low-income homeowners with high property taxes, since benefits have to be given to other qualifying homeowners. In fact, cost considerations, among other factors, prompted Wisconsin to reject the traditonal homestead exemption approach and to adopt the first circuit breaker in 1964.

Tax Freeze at Age 65

Only a small number of states have tax freeze programs. (In 1979, there were four such states.) A tax freeze may apply either to the assessment level, the tax rate, or both, freezing the tax liability as of age 65 (or some other specified age). The freeze may be applicable only to those with limited income or limited property value.

From the senior citizen taxpayer's point of view, a tax freeze has the advantage of protecting against increases in taxation resulting from escalating property values or tax rates after normal retirement age. Thus, those approaching retirement would be able to project and plan for an important element of their living expenses. A disadvantage is that the tax freeze does not provide property tax relief in cases where the property value escalated shortly before retirement.

From the governmental standpoint, the tax freeze would mean a permanent loss of revenues--the difference between taxes at current assessments and the frozen level. It would mean that two houses with equal market value would have different tax liabilities. There would also be administrative costs for establishing a freeze system so that the gross tax assessment on the books would be coupled with a "frozen" assessment to be used for tax billing purposes.

Tax Deferral for the Aged

A tax deferral program permits eligible homeowners (usually limited to elderly with low or moderate incomes) to defer all or part of their property tax payments, which then become a lien on the property, to be collected upon transfer of title to someone other than the spouse. Some programs provide for the addition of interest on the deferred taxes.

A small but growing number of states have tax deferral programs, either statewide or optional at the local government level, to supplement circuit breakers.

The main advantage of the tax deferral concept from the property owner's standpoint is that the property owner can continue to live in his home without worries about increasing real estate taxes. The main disadvantage is the need to encumber the property. This may create problems at time of transfer of title, when an heir may be forced to sell the property, often at times which are otherwise most difficult.

From the governmental standpoint, tax deferral is less costly than other tax relief measures, since the deferred taxes will eventually be recovered. There are also arguments for deferral of the elderly homeowner's tax liability in cases of escalating property values; at a later time the heirs must pay the deferred taxes.

Deferral would have the disadvantage of requiring extra recordkeeping to tally the deferred taxes (and calculate interest, if included in the program) compared to a tax freeze or outright rebate program.

Experience with deferral in other states indicates that, in general, relatively few eligible homeowners take advantage of the opportunity. Thus, it would be difficult to gauge the fiscal impact on Philadelphia if deferral were under consideration. The data from other states would provide a very rough guideline, but circumstances vary in each state. Thus, an extensive attitude survey of Philadelphia homeowners would be needed to determine the approximate range of costs in the early years.

Some argue against deferral on the ground that the light usage elsewhere indicates that most elderly don't want to be part of a program which requires putting a lien on their property. The counteragument is that a deferral program should be available as a supplementary safety valve to the circuit breaker to prevent hardship.

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In 1982, Philadelphia ordinances were enacted authorizing installment-payment agreements with low-income taxpayers and with persons age 65 and over with low incomes. The limits ($15,000 for one person ranging up to $24,200 for a 10-person household) are to be raised annually by an amount equal to three quarters of the increase in the consumer price index.

For **senior** citizens, installment agreements on property taxes may extend beyond the end of the year. An agreement for a term beyond December 31 will "jeopardize entitlement to the Pennsylvania Senior Citizens Real Property Rebate and result in a lien against the household."

While not providing a permanent deferral of taxes for senior citizens, the ordinance does permit extending the payment over more than one year. This could help reduce hardship if a substantial rise in assessment increases the property tax greatly.

APPENDIX A. Text of Pennsylvania Constitution Permitting Special Tax Exemptions for Needy Citizens

Article VIII, Taxation and Finance, Section 2, Exemptions and Special Provisions

(b) The General Assembly may, by law:

(ii) Establish as a class or classes of subjects of taxation the property or privileges of persons who, because of age, disability, infirmity or poverty are determined to be in need of tax exemption or of special tax provisions, and for any such class or classes, uniform standards and qualifications. The Commonwealth, or any other taxing authority, may adopt or employ such class or classes and standards and qualifications, and except as herein provided may impose taxes, grant exemptions, or make special tax provisions in accordance therewith. No exemption or special provision shall be made under this clause with respect to taxes upon the sale or use of personal property, and no exemption from any tax upon real property shall be granted by the General Assembly under this clause unless the General Assembly shall provide for the reimbursement of local taxing authorities by or through the Commonwealth for revenue losses occasioned by such exemption;

Source: Constitution of Pennsylvania, Article VIII, Section 2, as amended by Proposal No. 5 submitted to the electorate by the Pennsylvania Constitutional Convention of 1967-68.

APPENDIX B. Viewpoints on the Regressivity of the Real Property Tax

Economists differ as to whether the real property tax is regressive, proportional or progressive. (A tax is regressive if it is a higher percentage of income for families at the lower end of the income scale than for those at the upper end.) The basic view as to the real estate tax on housing is that, if the incidence of the tax falls on consumers, it is regressive, since low-income persons spend more of their income on housing than higher-income persons. However, if the tax falls on owners of capital, the tax is progressive, since ownership of capital increases with income. There are various viewpoints as to the degree of shifting, if any, from the owners to the consumers, and thus various views as to the overall incidence.

This report is concerned with the property tax as it impacts on owner-occupied residences. Here the consumers and the owners are identical. The traditional view is that the residential property tax for homeowners is regressive, and this view is substantiated by survey data relating direct property tax payments to the current annual income of the homeowner. A good example is the 1970 residential finance survey; this is often cited by the Advisory Commission on Intergovernmental Relations.*

The traditional view has been challenged by some economists on the ground that the surveys relating annual tax payments to annual income use inadequate or misleading measures of income. First, the income measure should include nonmonetary income such as imputed rent from home ownership; this would push many of the home owners into higher income classes. Second, and more important, the measure of income should not be annual income, but should be "normal" or "permanent" income. The reason for using "normal" income, rather than income in one year, is that family decisions regarding housing expenditures are conditioned by the flow of income over a much longer period then just one year. The revisionists contend that the property tax ranges from neutral to progressive when compared to long-term normal total income. A leading exponent of the revisionist viewpoint is Henry J. Aaron.**

There are those who agree that the revisionist position is probably correct and that the homeowner's property tax is probably proportional to "normal" income of homeowners. Nevertheless, the traditionalists argue that this finding does not provide a basis for public policy, because there are many aged, or disabled, or unemployed who face problems in paying property taxes precisely since their incomes are below the "normal" level.

Thus, whether the residential property tax is considered progressive or regressive overall, there is general agreement that some persons do suffer from extremely high property taxes in relation to current income.

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* ACIR, Property Tax Circuit Breakers, p. 14.

** Who Pays the Property Tax? A New View (Washington: The Brookings Institution, 1975), p. 35.