WASHINGTON RESEARCH COUNCIL

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A Citizen's Guide to Property Taxes

In this *Citizen's Guide*, the Washington Research Council examines the characteristics of Washington State's property tax system. We trace the history of the tax, review principles of equity and uniformity, and consider the level and distribution of the tax burden. Finally, we review the various limitations and exemptions associated with the property tax.

The review is timely. On November 8, the Washington State Supreme Court invalidated Initiative 747, which would have kept property tax revenues from increasing by more than 1 percent per year. In response to public outcry, the governor called the legislature into special session to address the court ruling. Meeting on November 29, the legislature reinstated I-747's one-percent levy cap and established a property tax deferral for low and moderate-income property owners. The legislature is expected to take a more comprehensive look at the state's property tax system during the regular 2008 session.

This *Guide* is designed both to place today's debate in historical perspective and to inform the discussion with current facts and tax policy principles.

Over time, reliance on the property tax has diminished. Before the Great Depression, the property tax provided more than 90 percent of the funding for state and local government in Washington; today, it yields less than 20 percent. Even as its relative importance declined, the tax remained controversial, often the target of taxpayer revolt. A succession of reforms has added complexity to the tax system. We now have regular levies and excess levies, the one-percent limit and the 101 percent limit, exemptions and deferrals, and more.

Generally the reforms have remained consistent with fundamental tax principles enshrined in the state's governing documents: Property "shall be taxed in proportion to its value"—"all taxes shall be uniform on the same class of property"—"all real estate shall constitute one class." To ensure the equity of the tax system, reformers have also acted at various times to improve assessment practices, ultimately adopting 100 percent valuation as the standard.

In the following pages, we consider the effects of these reforms on today's property tax policies. As well, we attempt to build a framework for thoughtful evaluation of alternative proposals as they emerge for public consideration.

For additional information, or to arrange for a presentation on tax policy, please call the Washington Research Council at (206) 467-7088.

OVERVIEW

Washington's state and local governments levied $7.73 billion in property taxes for payment in 2007, an increase of 7.1 percent over the $7.21 billion levied for 2006. The 2007 taxes represented $1,191 per state resident and just under 3 percent of state personal income.

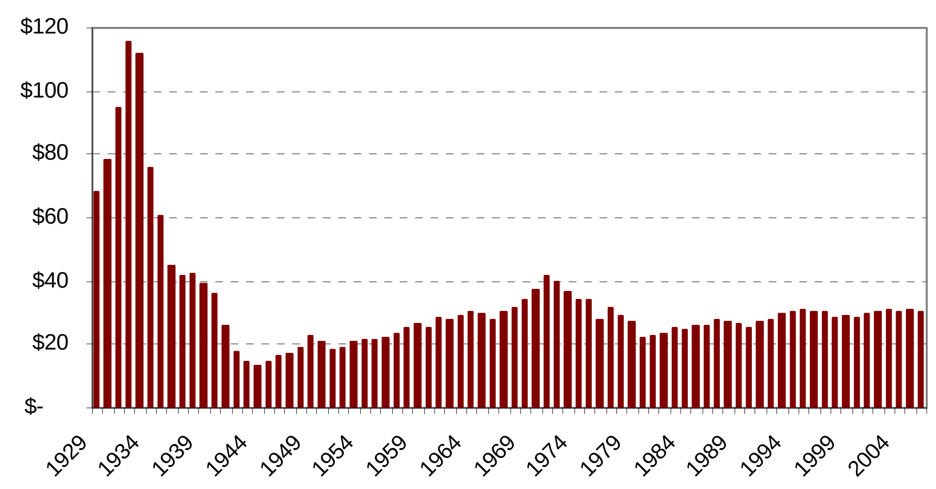
In the first years following statehood, the property tax was the principal state tax. The state constitution originally included the paragraph:

> Annual State Tax- All property in the state, not exempt under the laws of the United States, or under this Constitution, shall be taxed in proportion to its value, to be ascertained as provided by law. The legislature shall provide by law for an annual tax sufficient, with other sources of revenue to defray the estimated ordinary expenses of the state for each fiscal year. And for the purpose of paying the state debt, if there be any, the Legislature shall provide for levying a tax annually, sufficient to pay the annual interest and principal of such debt within twenty years from the final passage of the law creating the debt.

Until the 1930s most state and local revenue came from taxes of property. In 1927, for example, property taxes accounted for more than 90 percent of state and local revenue in Washington. Like many other states, Washington adopted major new taxes during the Great Depression in order to reduce reliance on the property tax. In 2005 property taxes accounted for 19.5 percent of state and local revenues.

In 1929, $78 million in taxes were collected from property owners. This amounted to 6.8 percent of the $1.14 billion personal income for state residents. By 1932 the amount collected had been reduced slightly to $73 million. State personal income, however, had fallen by a much greater percentage to $625 million, and the burden of the levy had increased to 11.7 percent of personal income.

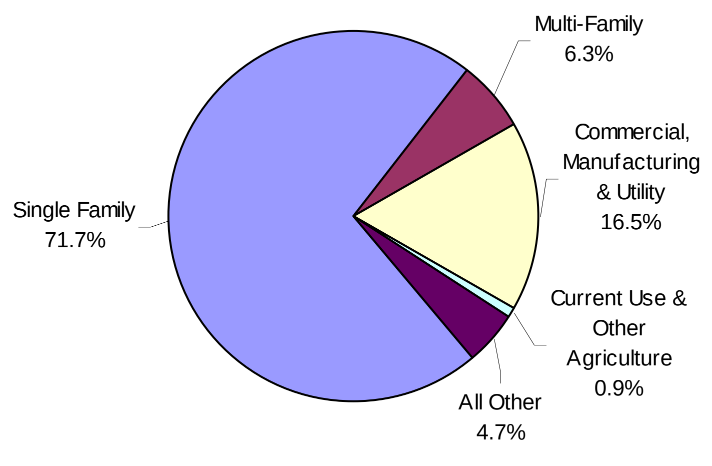
Figure 1: Property Taxes Collected per $1,000 of Washington State Personal Income



Property tax delinquencies soared during the Great Depression, reaching 30 percent of the current tax roll in 1932 and 1933, while falling property values further strained the system. In 1932 the voters approved an initiative to limit property taxes to 40 mills, that is four cents for each dollar of assessed valuation. (At that time property was typically assessed at only a fraction of its true value.) In 1933 the Legislature imposed a temporary tax on business gross receipts. After voters in 1934 rejected a graduated income tax, the 1935 Legislature enacted the Revenue Act, which imposed a number of taxes including a permanent Business and Occupation (B&O) tax and a 2 percent sales tax. In addition, the Revenue Act granted further property tax relief by exempting all household goods and personal effects from the property tax.

Figure 1 shows the property taxes due, from 1929 through 2006, in relation to state personal income. From the 1932 peak of $117 per $1000 of personal income, collections fell to a low of $13 per $1000 in 1944, the year that the 40 mill limit was placed in the state constitution. This same constitutional amendment mandated that property be assessed at 50 percent of true and fair value. From the 1944 low, taxes began a slow but steady climb. After 1966 the rate of increase accelerated, in part because of special school levies tied to the baby boom. The post-war peak of $42 per $1000 of personal income was reached in 1971.

Figure 2: Distribution of Real Property in 2006



The early seventies saw the state's second wave of property tax reform. In 1971 the 106 percent limit, capping the annual increase in regular property taxes at 6 percent, was introduced. In 1972 the state constitution was amended to limit regular property taxes to one-percent of true value.

The tax burden declined to $23 per $1,000 of personal income in 1980. From that low it increased steadily, reaching $31 in 1995. It has decreased slightly since then, and in 2006 was equal to $29.31 per $1,000.

WHAT IS PROPERTY?

The state constitution defines property broadly to "mean and include everything, whether tangible or intangible, subject to ownership." The 14th Amendment, which added this definition to the constitution in 1930, also enabled the Legislature to define separate classes of property. Within each class tax rates must be equal. Different classes however, can be taxed at different rates.

Property is divided into two broad types. *Real property*, in general, consists of land and everything that is permanently affixed to land. All else is *personal property*. The constitution requires that real property be a single class. By statute, business and household personal properties are separate classes, and household personal property is exempt from taxation.

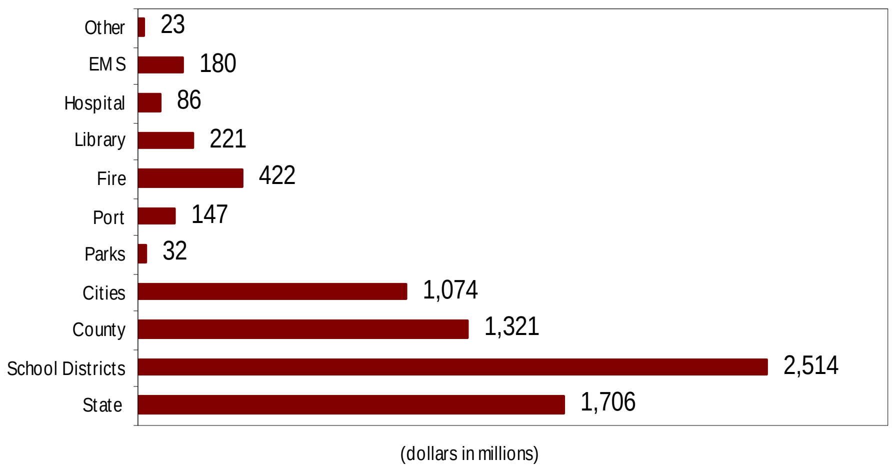
In 2006, 4.8 percent of the assessed value subject to the property tax was personal property while the remaining 95.2 percent was real. Almost all of the taxable personal property belonged to businesses, mostly machinery and equipment. Figure 2 shows the breakdown of real property. Single-family homes represented almost 72 percent of the assessed value of real property. Multi-family homes represented more than 6 percent; commercial and manufacturing uses, 16.3 percent; all else, 5.5 percent.

WHO IMPOSES THE PROPERTY TAX?

The Washington landscape is overlaid by more than 1,700 separate districts that, in addition to the state itself, have the power to levy property taxes. These include 39 counties, 270 cities and towns, 296 school districts, 413 fire districts, 16 library districts, 76 ports and 128 emergency medical services (EMS) districts.

Figure 3 breaks down the $7.7 billion in property taxes due in 2007 by the type of taxing district. The state receives the largest single share of property tax levies, 22 percent, although in aggregate the 32 percent share of school districts is larger. Seventeen percent went to counties. Cities and towns took 14 percent, and all other districts, 14 percent.

Figure 3: Levies Due in 2007 by Type of District



Washington state government does not compile comprehensive statistics on local government taxation and spending. The Bureau of the Census's annual survey of government finances, however, provides a picture of state and local government finances. The Bureau reports that state and local government general revenue totaled \$42.3 billion in Washington for fiscal year 2005. Of that money, \$8.3 billion came from the federal government. The state itself collected \$19.6 billion in taxes and fees, while local governments collected \$14.4 billion. Additionally, the state transferred \$7.8 billion (net) to local governments. Much of this money went to school districts.

Figure 4 summarizes the sources of revenues for Washington governments. Property taxes provided the second largest share of the taxes and fees collected by the combined governments, after general sales taxes. The Census Bureau includes the state's business and occupation tax in the general sales tax category. If the B&O tax was not included, general sales tax would still provide the largest share of revenue.

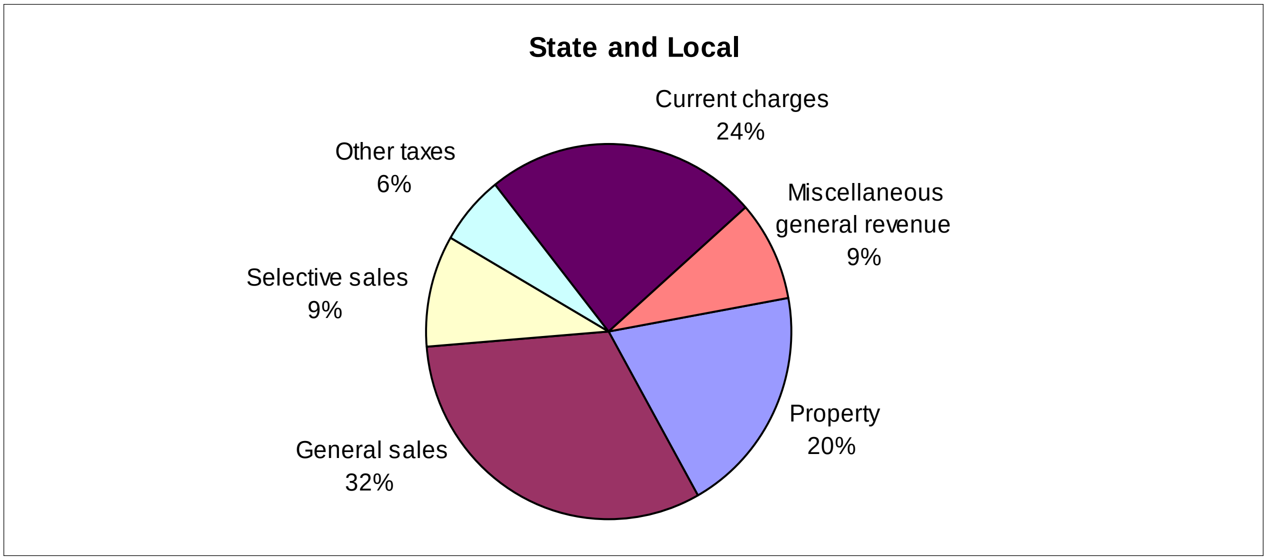
For the state alone, the property tax represents a smaller fraction of collections, 8 percent; general sales taxes generate a much larger share of the state's revenue. For local governments, the property tax is the largest source, 35 percent. Second, at 34 percent, comes the category of current charges, which includes user fees for such services as hospital care, sewage, garbage collection, seaports and airports.

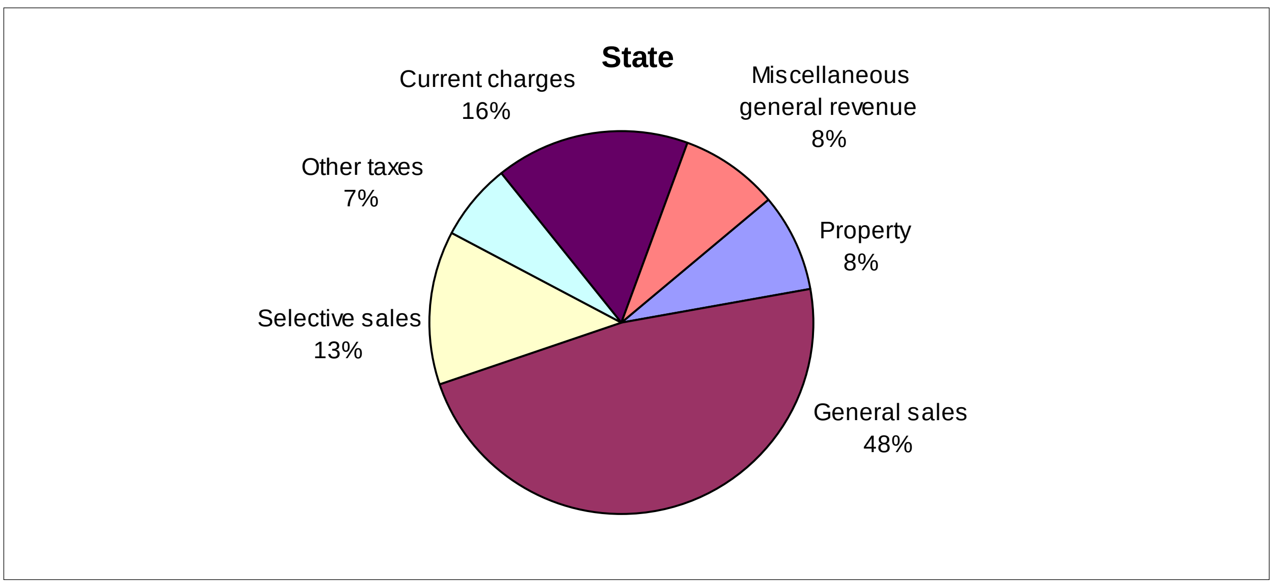
Figure 5 compares Washington's property taxes to those of the other 49 states and the District of Columbia for the 2005 fiscal year. In taxes per \$1000 of personal income, Washington ranked 27th. In taxes per capita, Washington ranked 25th. While in taxes as a share of own-source general revenue, the state ranked 29th.

THE ONE-PERCENT RATE LIMIT

In 1972 Washington state voters amended the state constitution to establish the one-percent limit on levies: "the aggregate of all tax levies upon real and personal property by the state and all taxing districts now existing or hereafter created shall not in any year exceed one percent of the true and fair value of that property in money." This was a modification of the 40 mill limit that had been established during the Great Depression. The one-percent limit is subject to five exceptions. First, it does not apply to the levies of ports and public utility districts. Second, the limit may be exceeded if a three-fifths majority of the district's voters approve. Generally voter approval for levies in excess of the limit must be renewed each year. Third, voters may approve levies to fund school operations with a simple majority. School operations levies may span four years and levies for

Figure 4: Breakdown of Washington State and Local General Revenue, Fiscal Year 2005





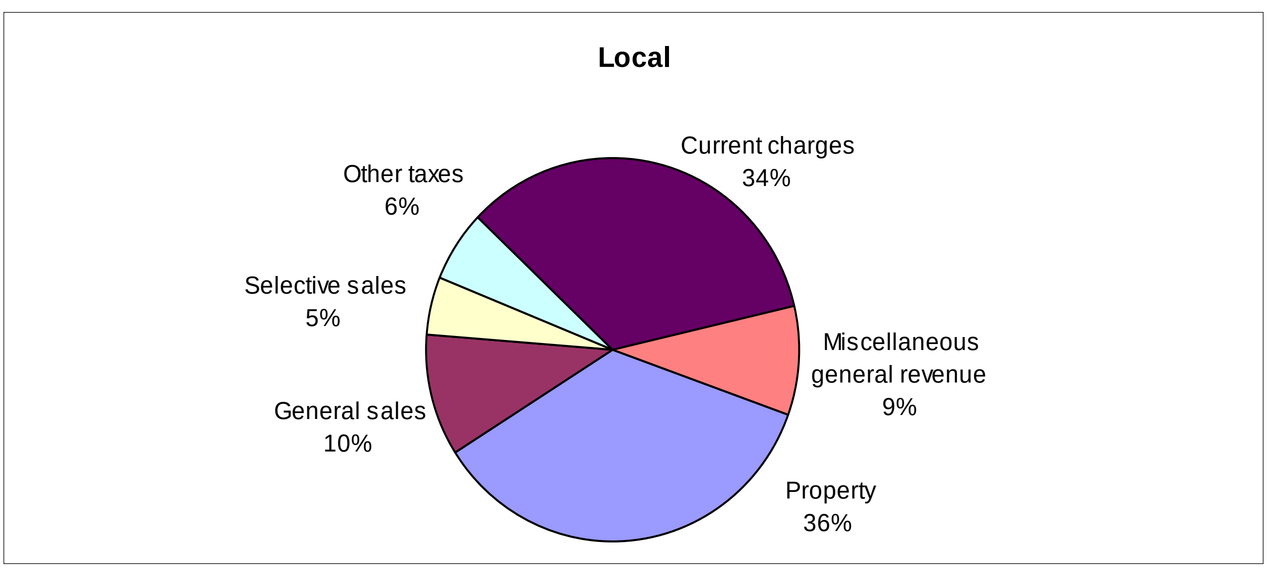


Figure 5: Property Tax Rankings of States, Fiscal Year 2005

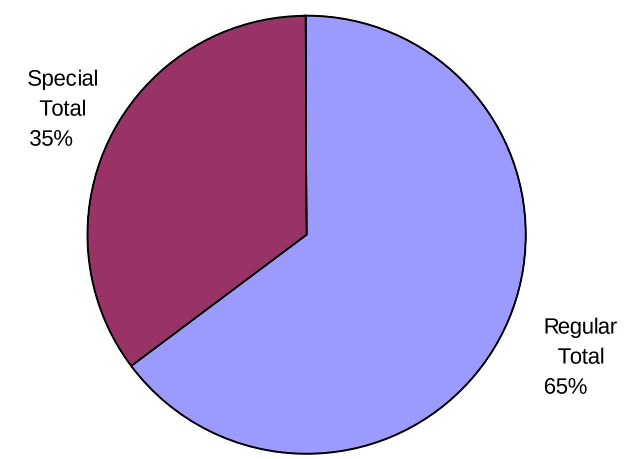
State	*Per $1,000 PI*	*Rank*	*Per Capita*	*Rank*	*Share of State and Local Taxes and Fees*	*Rank*
New Hampshire	52.68	1	2,028.07	3	43.5%	1
Maine	52.11	2	1,632.48	9	29.9%	6
Vermont	50.87	3	1,697.26	7	30.1%	5
New Jersey	50.31	4	2,205.71	1	34.4%	2
Wyoming	47.55	5	1,750.62	6	20.9%	21
Rhode Island	46.76	6	1,694.72	8	30.1%	4
New York	43.79	7	1,767.99	5	23.6%	13
Connecticut	42.63	8	2,044.06	2	30.9%	3
Wisconsin	41.95	9	1,410.37	12	26.3%	9
Texas	40.80	10	1,320.44	14	29.3%	7
Illinois	40.54	11	1,464.12	11	28.6%	8
Indiana	38.94	12	1,219.11	16	23.9%	12
Michigan	38.54	13	1,278.99	15	24.5%	11
Alaska	37.76	14	1,345.35	13	12.3%	43
District of Columbia	37.51	15	1,950.91	4	21.5%	20
Massachusetts	36.49	16	1,607.42	10	25.9%	10
Montana	36.28	17	1,067.09	23	23.3%	14
Nebraska	35.55	18	1,195.47	17	21.9%	19
Florida	34.50	19	1,147.51	18	22.4%	17
Iowa	34.45	20	1,113.55	20	22.0%	18
Kansas	34.29	21	1,124.53	19	22.9%	16
Ohio	32.16	22	1,043.88	26	20.0%	27
North Dakota	31.01	23	976.85	30	18.9%	30
South Carolina	30.99	24	880.36	35	18.2%	32
Pennsylvania	30.87	25	1,079.42	22	20.7%	23
Oregon	30.48	26	979.14	29	19.7%	28
Washington	**29.81**	**27**	**1,054.90**	**25**	**19.6%**	**29**
South Dakota	29.76	28	942.24	32	23.2%	15
Georgia	29.09	29	899.48	34	20.7%	22
Virginia	28.88	30	1,109.16	21	20.7%	24
Idaho	28.67	31	807.24	38	18.0%	33
Arizona	28.52	32	861.09	36	20.1%	25
Colorado	27.91	33	1,059.42	24	20.0%	26
Minnesota	27.37	34	1,024.21	27	17.5%	36
Nevada	26.78	35	962.06	31	17.7%	34
Mississippi	26.60	36	676.45	41	16.7%	37
Utah	25.87	37	719.76	40	15.2%	41
California	25.45	38	942.03	33	15.8%	40
Missouri	25.38	39	809.89	37	18.5%	31
North Carolina	24.31	40	743.69	39	16.2%	38
Maryland	23.92	41	1,000.85	28	17.6%	35
Louisiana	21.64	42	538.99	46	11.0%	46
Tennessee	21.00	43	653.89	42	15.8%	39
West Virginia	20.39	44	555.88	45	11.5%	44
Kentucky	18.88	45	538.48	47	12.7%	42
Hawaii	18.58	46	642.62	43	10.8%	47
Oklahoma	16.52	47	485.02	48	11.3%	45
New Mexico	16.19	48	448.12	49	8.9%	51
Arkansas	15.70	49	422.33	50	10.0%	48
Delaware	15.54	50	577.19	44	8.9%	49
Alabama	13.50	51	394.06	51	8.9%	50
United States	32.74		1,132.11		21.2%	

school construction may be for up to six years. Fourth, when voters of a district, by three-fifths majority, approve the issue of general obligation bonds to fund capital investments, levies to pay interest and principal are not subject to the limit. Fifth, a court of last resort can order levies over the limit to prevent impairment of contractual obligations.

With few exceptions, taxes levied within the one-percent levy limit are termed *regular* levies, while those outside of the one-percent limit are *excess* or *special* levies.

The constitutional one-percent limit is implemented through a complex web of state statutes. Property must be assessed at 100 percent of true value, and tax rates must be stated in terms of dollars per $1000 of value. The one-percent limit thus limits regular property taxes to $10 per $1000. Statutes cap the rate of regular property tax for each type of district. Of the $10 limit, $3.60 is reserved for the state and an additional $ 0.50 is available for three special purposes: open space preservation, emergency medical services, and affordable housing. The remaining $5.90 is available to local districts.

Figure 6: Levies due in 2007



Counties, road districts and cities are termed senior districts and get first call on the $5.90: Counties are allocated $1.80; cities receive $3.60 (if, however, library or fire protection services are provided by separate districts rather than by the city itself, the city will receive less than $3.60); county road districts, which build and maintain roads outside of city limits, get $2.25.

The remainder of the districts, or junior districts, also have statutory limits on their tax rates. The maximum tax rates for all of the districts within which a specific property lies may well sum to more than $5.90. In the event that the districts in aggregate levy more than $5.90, the money is distributed according to a priority list set by law.

Although they are exempt from the one-percent constitutional limit, the levies of ports and public utility districts are limited by statute, and levies within these limits are classified as regular levies by the Department of Revenue.

Figure 6 shows the breakdown of 2007 levies. The Department of Revenue classifies $5 billion, or 65 percent, as regular levies and $2.7 billion, or 35 percent, as special levies. The statewide average tax rate of $10.48 per $1000 of assessed valuation divides into $6.81 for regular levies and $3.67 for special levies.

The statutes require that voters approve the regular emergency medical service and parks levies; these represented about $180 million in 2007.

Uniformity in Taxation

Uniformity of taxation has long been recognized as an important principle of equity in property taxation. Uniformity embodies the fundamental notion of fairness that taxpayers in essentially the same circumstances should pay essentially the same taxes. It also provides protection against the majority attempting to pass the cost of government onto a minority. As Alexander Hamilton warned, “Whenever a discretionary power is lodged in any set of men over the property of their neighbors, they will abuse it."

When the 1853 Organic Act established the government of Washington Territory, the U.S. Congress was particularly worried that the Territory's residents would try to shift the burden of taxation onto nonresidents. "Nor shall the lands and other property of nonresidents be taxed higher than the lands or other property of residents . . . And all taxes shall be equal and uniform; and no distinctions shall be made in the assessments between different kinds of property, but the assessments shall be according to the value thereof."

The original state constitution adopted in 1889 required strict uniformity in taxation, and it remains an important constitutional principle today: "All taxes shall be uniform on the same class of property within the territorial limits of the authority levying the tax . . . All real estate shall constitute one class . . ."

ASSESSMENTS

The constitution stipulates that the tax is to be levied against "the true and fair value" of property. Assessment is the process by which this value is specified. For most property in the state a county assessor makes the assessments. The remaining property, public utilities that operate between counties, privately owned railroad cars and commercial boats, is assessed by the state.

The tax on a particular property is calculated by multiplying its assessed value by a tax rate. The 1889 state constitution recognized that to be effective, uniformity must apply to both assessments and tax rates. "The Legislature shall provide by law a uniform and equal rate of assessment and taxation on all property in the state, according to its value in money, and shall prescribe such regulations by general law as person and corporation shall pay a tax in proportion to his, her, or its property." Through every subsequent amendment, uniform assessment has remained a constitutional requirement.

Uniform assessments are necessary for an equitable system of property taxes. In 1944 the state constitution was amended to require that property be assessed at 50 percent of its true value. Local assessors ignored this constitutional requirement, however. Assessment at 25 percent seems to have been common, and for many properties, the assessed value was an even smaller percentage of true value. With the 40 mill rate cap, taxes were effectively limited to one percent of true and fair value.

In the early 1950s, following the imposition of the real estate excise tax, the state began to receive accurate data on the sale prices of real property. These data revealed serious inequities among taxpayers in the ratios of assessed value to market value. The 1955 Revaluation Act began with this legislative declaration: "[G]ross inequality and non-uniformity in valuation of real property for tax purposes [are found] throughout the state . . . Such non-uniformity . . . is of such flagrant and widespread occurrence as to constitute a grave emergency adversely affecting … the welfare of all the people." Frequent reassessments help assure that property owners are treated uniformly. To improve fairness, the 1955 Act required that no property should go more than four years without its value being reassessed.

The inequities in assessments, however, persisted. Many counties failed to comply with the 1955 act, and, in at least one case, the county assessor was not applying the same assessment ratio to all property. In 1969, to force uniformity, the state Department of Revenue ordered county assessors to adopt the constitutional 50 percent standard, beginning with the 1970 assessment year.

The 55th amendment, which also limited regular taxes to one percent of true and fair value, removed the 50 percent standard from the state constitution. The next year (1973), the Legislature mandated that property be assessed at 100 percent beginning with the 1975 assessments. Reformers, under the banner of "truth in taxation," had long advocated 100 percent valuation as the easiest way for taxpayers to understand the relationship between property value and property taxes.

Today, 19 of the 39 counties in the state revalue on a four-year cycle. Eighteen counties including King County, which represents 40 percent of assessed value within the state, revalue annually. One county, San Juan, revalues every two years, while another (Douglas County) revalues every three years.

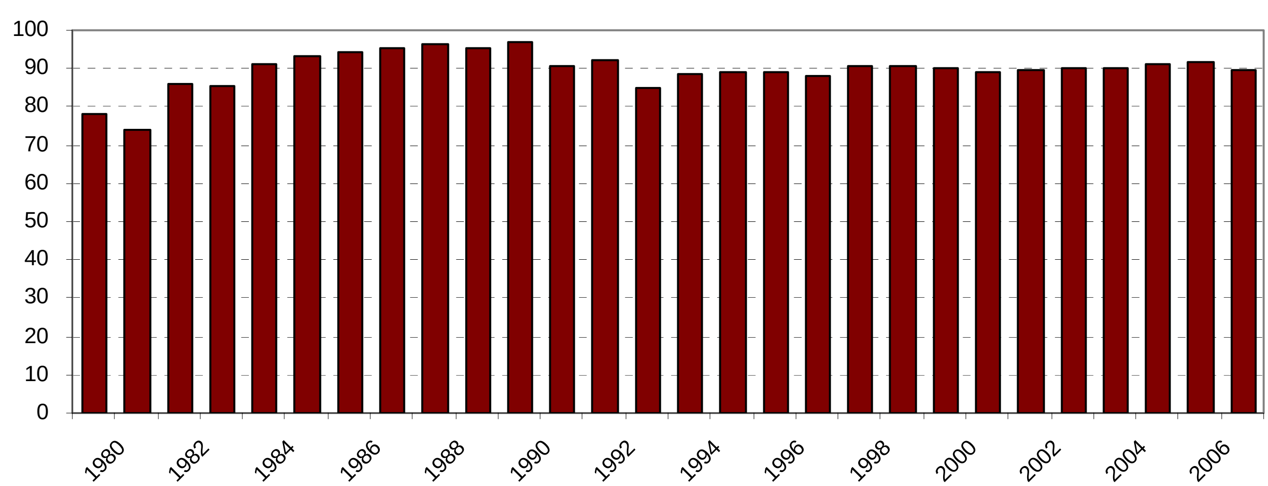
By May 31, each assessor is expected to list on the county tax roll his assessment of the January 1 value of all property other than new construction. The listing deadline for new construction is August 31. Taxpayers must file any assessment appeals with the county board of equalization by July 1 or by the thirtieth day following the mailing of a notice of revaluation, whichever is later.

The county treasurer mails tax bills after February 15. The first half of the tax is due by April 30; the second half by October 31.

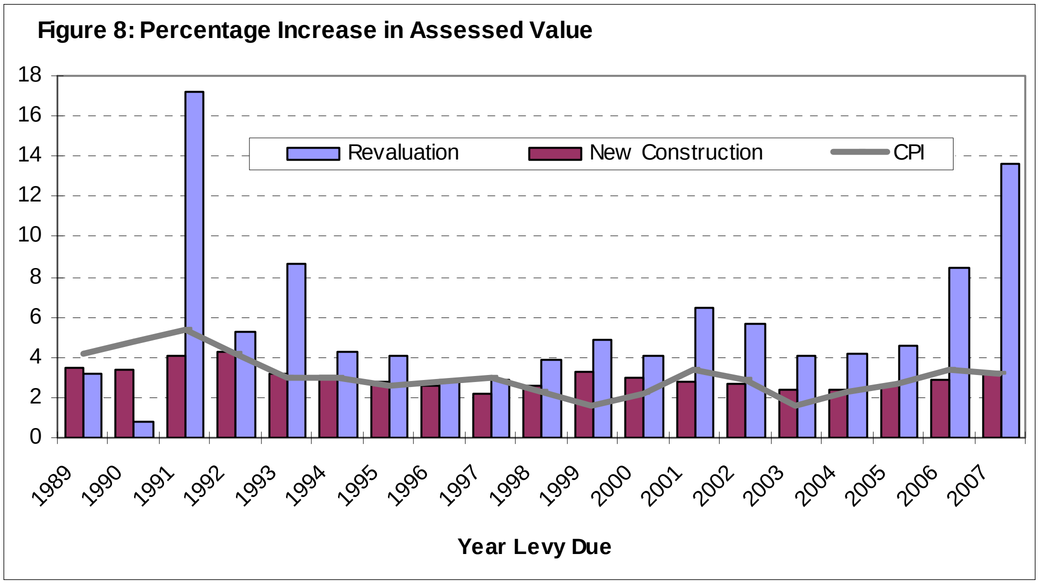
The taxes due in any particular year are based upon the preceding year's assessment; this can be a source of confusion. To clarify, the taxes due in 2007 are the taxes levied on 2006 assessed values, while those levied on 2007 values are due in 2008. Throughout this *Guide*, taxes are identified with the year in which they are due.

Each year the state Department of Revenue estimates county by county the average relationship between the assessed value and the true and fair value of the property. These estimates are used to assure that differences in county assessment practices do not lead to inequities in the distribution of

Figure 7: Assessed Value as a Percentage of True Value



the burden of the state portion of the property tax. For the 2006 assessment, the ratio of assessed to true values ran from a low of 0.603 in Pend Oreille County to 0.945 in Island County. For King County the ratio was 0.868, while the average for the state was 0.871.



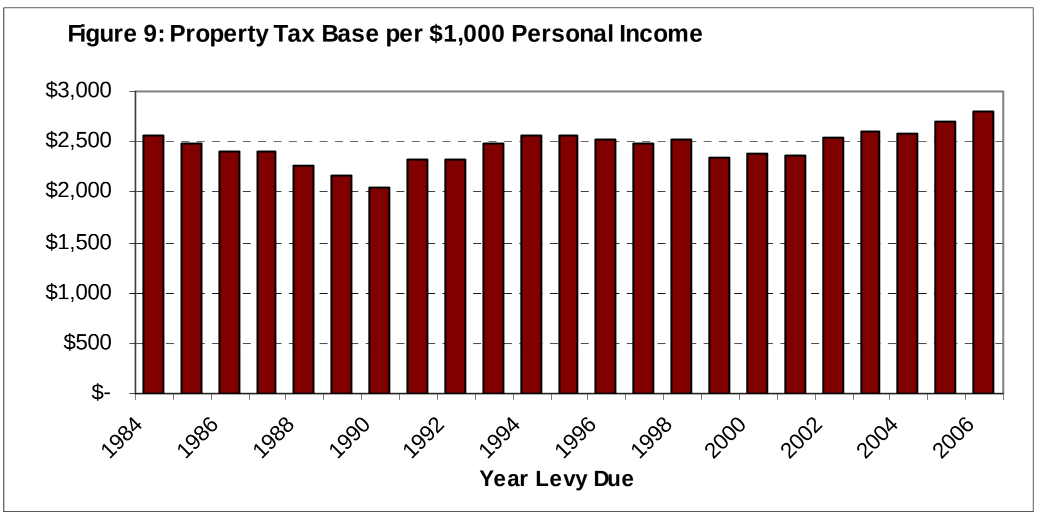


Figure 7 shows how the overall ratio for the state has varied over the years since the assessment ratio was raised from 50 percent to 100 percent. Two troughs are clearly evident. In the late 1970s assessed values lagged behind as inflation in the general level of prices pushed up the true value of property; as a result the ratio fell. With the abatement of general inflation in the 1980s, assessments moved much closer to true values, and the ratio rose, reaching 97 percent for the assessment year 1988. Subsequently a number of areas in the state, most notably King County, experienced real estate booms. Assessed values lagged behind true and fair values.

The assessed value for taxes due in 2006, $702 billion, was more than twice the $314 billion for 1996. Virtually all of this change can be accounted for by construction of new property and revaluation of existing property. Figure 8 shows by year the percentage in statewide assessed value. During the second half of the 1980s, new construction represented the larger share of the increase in the general level of consumer prices as measured by the Consumer Price Index (CPI). In the 1990s revaluations exceeded both new construction and CPI inflation.

The 16 percent increase in assessed value due to revaluation for taxes due in 1991 (reassessments conducted in 1990) is primarily the effect of the King County real estate boom. The county's 1990 reassessment increased the value of existing real property by more than 38 percent!

In Figure 9 the ratios of true to assessed values have been used to calculate the property tax base relative to state personal income from 1984 to 2006. The base rose sharply from 1990 to 1995, dipped in 1999–2001 and then rose again during the recent house-price boom.

Current Use Assessment

In 1968 voters approved Amendment 53 to the state constitution creating an exception to the general requirement that all real property be treated as a single class. Under this amendment it became possible for the Legislature to allow agricultural lands, timberlands, and other open spaces to be assessed according to their values in their current uses. In 1970 the Legislature established a program for current use assessment, and then in 1973 the program was extensively expanded.

The Legislature has found that certain uses of lands bring special public benefits and that owners should not be forced to withdraw property from these uses simply to pay the property taxes: “To assure the use and enjoyment of natural resources and scenic beauty for the economic and social well-being of the state and its citizens…assessment practices must be so designed as to permit the continued availability of open lands for these purposes.”

In 2006, 11.5 million acres of land, with an assessed value of $3.9 billion, were enrolled in the program.

When property is removed from current use assessment, the owner must pay a tax equal to the current use tax reduction enjoyed over the proceeding ten years, plus interest.

THE 101 PERCENT GROWTH LIMIT

Spending decisions generally determine the property tax levy of local governments. The 1971 Legislature, however, imposed an annual limit on the increases in local governments’ revenues from property taxes. Under this law, regular property tax revenues for any taxing district could only increase by 6 percent from the pervious year plus the previous year’s tax rate applied to the value of new construction. The 1979 Legislature extended this limit, commonly called the 106 percent limit, to the state levy.

Referendum 47, which voters passed in 1997, tightened the 106 percent limit. R-47 limited the rate of a district’s tax revenue growth to the lesser of inflation or 6 percent revenues plus an increment for new construction, with a few exceptions. Local taxing districts with less than ten thousand people were allowed up to 6 percent increases irrespective of the rate of inflation, while larger districts could increase tax collections up to 6 percent if elected officials found a “substantial need” to exceed the inflation limit. This would require a supermajority vote of the county or city council. Increases in excess of 6 percent were allowed in the event that voters approved a *lid lift*.

In 2000, voters passed Initiative 722, which replaced the 106 percent limit with the 102 percent limit. This limited revenue growth to the lesser of 2 percent or inflation with the same exceptions.

In November of 2000 the constitutionality of I-722 was challenged in court. In response, I-722’s supporters filed Initiative 747, presumably as a safety net should I-722 be invalidated. I-747 further reduced the growth limit factor to the lesser of inflation or 101 percent of the previous year’s collections.

In September 2001, the Washington State Supreme Court ruled I-722 unconstitutional. In November 2001 voters passed I-747.

On November 8, six years after its passage, the Washington State Supreme Court found I-747 unconstitutional, violating the constitutional provision requiring an initiative to clearly set forth the statute(s) it would amend. The text of I-747 stated it would reduce the growth limit factor from 102 percent (as per I-722) to 101 percent. However, before the election, I-722 had been declared unconstitutional. Therefore, I-747 actually reduced the growth limit factor from *106 percent* to 101 percent.

The governor then called a special session of the legislature to reinstate the 101 percent limit. The legislature met on November 29 and passed HB 2416, which limits the levy for a taxing district to the lesser of inflation or 101 percent of the previous year's revenues plus an increment for new construction.

Revenue Growth Limits

The 101 percent revenue limit restricts the total property tax revenue that any taxing district can raise. It does not restrict the taxes levied against a particular property and it applies only to *regular*, but not *special* levies.

The cap on a district's total revenue in any year is equal to 101 percent of the highest amount levied in the preceding three years plus the previous year's tax rate applied to the value of new construction and improvements. Property tax collections shall not exceed the cap; local governments are not required to levy to the maximum and they can 'bank' any unused taxing capacity to be collected at a later date.

Figure 10A: Total Revenue

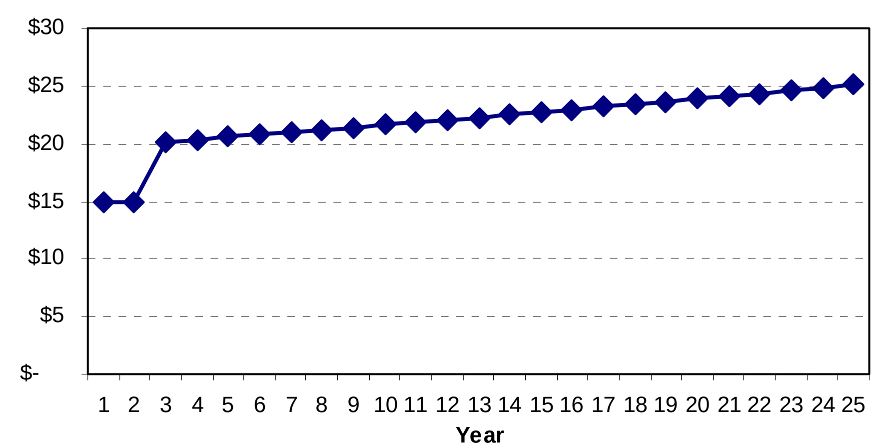
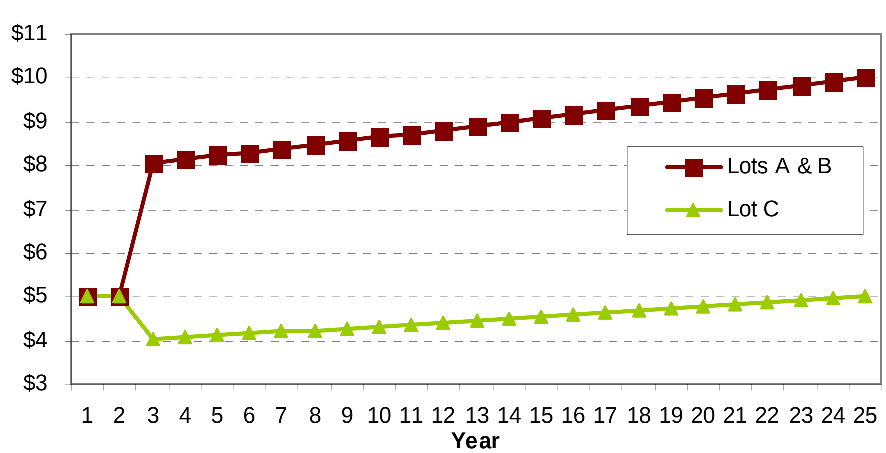


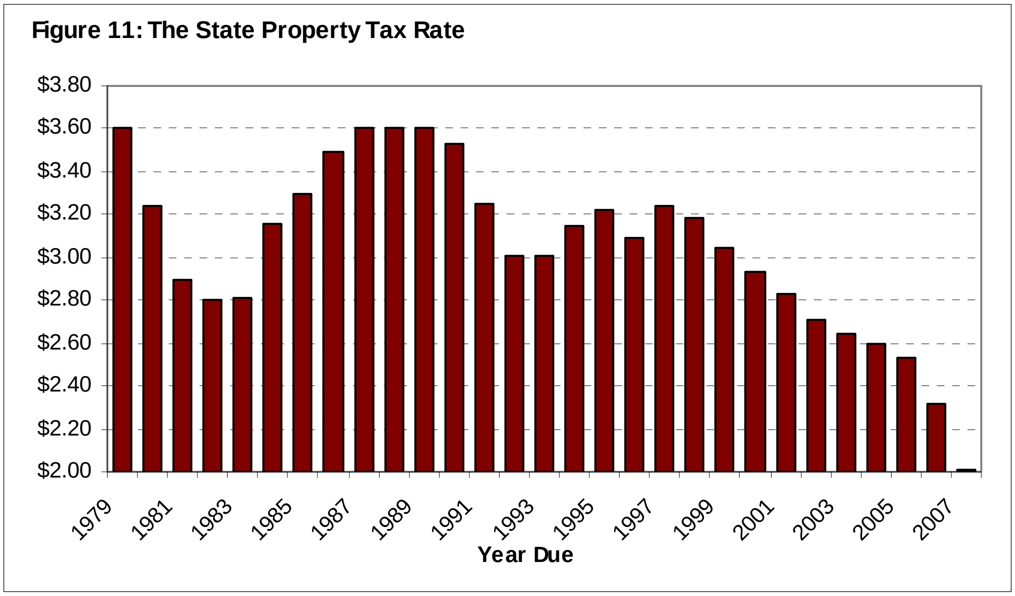
Figure 10B: Taxes by Lot



With the cap, individual taxpayers may be affected quite differently. The tax rate may increase or decrease to generate the revenue allowed under the limit, subject to other limitations, and the effect on individual properties will vary depending on changes in assessed valuation in the taxing jurisdiction as the following illustration demonstrates.

Consider a simple district, which has a maximum tax rate of $5 per $1000 of assessed value and encompasses just three vacant lots, each worth $1000. The total annual tax revenue for the district would be $15; each owner would pay $5. Imagine that one year, call it year 1, the market value of one of the lots—lot A—doubles, while the values of the other two lots—B and C—are unchanged. The owner of lot B, however, constructs a house worth $1000 on his lot. For year 2, the district's assessor will revalue both A and B from $1000 to $2000. But since in any year the taxes paid on a property depend upon the previous year's assessment, taxes paid in year 2 will still be just $5 for each property. In year 3 the increased assessments would first affect taxes. Without the 101 percent limit, the annual taxes on both A and B would jump directly to $10 and the district's total revenue would be $25. With the 1 percent limit the increase is spread out over a number of years, as shown in Figure 10.

Year 3 taxes are limited to 101 percent of year 2 taxes, or $15.15, plus the tax of $5 per $1000 applied to the value of the new construction, an additional $5. Thus the 101 limit means that the district can only collect $20.15 in total revenue in year 3. To achieve that revenue with a tax base of $5000 requires a tax rate of $4.03 per $1000. Owners A and B each pays $8.06, while C pays $4.03.



The important thing to recognize is that the 101 percent limit applies to the total tax received by the district, not the tax paid by any one property owner. In this example, the taxes paid by A and B rose by 61.2 percent, while the tax paid by C fell by 19.4 percent.

The next year the taxes for each owner would be 1 percent higher, $8.14 for A and B, and $4.07 for C. Not until year 25 would taxes reach $5 per $1000 of assessed value. In the real world, though, property values are likely to change again before the full adjustment is reached.

Figure 11 shows the state property tax rate over the period of 1979-2007. From 1979 to 1982 and again from 1989-1992 property values increased by more than 6 percent a year. As a result the state tax rate fell. In both cases, growth in property values slowed. Tax rates rose back towards the statutory rate of $3.60 per $1,000 in 1984. The tax rate has been steadily decreasing since 1997.

The legislature has broadened the provision that allows voters to approve tax increases above the 101 percent limit. A single lid lift vote may now authorize super-limit annual increases for up to 6 years.

Exemptions

A number of exemptions to the property tax have been established either constitutionally or through statute. Every exemption, by reducing the tax base, increases the tax rate other property owners must pay if a district is to raise a fixed sum of money.

Although the Organic Act required that all property be taxed equally within Washington Territory, it did explicitly exempt federal property from the tax. The first Legislative Assembly chose to exempt churches, cemeteries, and non-profit libraries. These exemptions continue today and are estimated to reduce revenue from the property tax by $66.4 million annually.

The initial state constitution exempted the property of the federal, state and local governments. The constitution also gave the Legislature the power to exempt other property. In 1988 the state constitution was amended to allow the taxation of federal property. Federal law, however, currently prohibits such taxation.

The Department of Revenue lists over one hundred separate exemptions from the property tax; according to DOR, annual savings to property owners from these exemptions are projected to average $24.4 billion over the 2007–09 biennium. Figure 12 summarizes these exemptions in broad categories of exemption.

In the private property category, the largest is the exemption for retired senior and disabled homeowners with low incomes. This exemption was allowed by Amendment 47 to the state constitution, approved in 1966. The Department of Revenue estimates the value of this exemption to be $100.5 million annually.The largest personal property exemption is that for intangible financial assets such as cash, bank deposits, loans and securities. This exemption became possible with the approval in 1930 of Amendment 14 to the state constitution and was implemented in 1931.

Figure 12: Annual Fiscal Impacts of Property Tax Exemptions

	State	Local
Public Property	$401.4 million	$1.7 billion
Non Profit Organizations	$53.1 million	$213.3 million
Private Property	$21.2 million	$100.0 million
Personal Property	$4.0 billion	$15.6 billion
Property Tax Deferral/ Valuation Freeze	$18.9 million	$63.8 million
Current Use Assessment	$26.7 million	$104.8 million

There are several justifications to exempting intangibles. In many cases these financial assets are paper claims to physical assets that are already subject to the property tax; thus the exemption simply avoids double taxation. Furthermore, financial assets are difficult for assessors to find if the owners do not voluntarily reveal their existence or if they move them out of the state. For this reason, a tax on intangibles is likely to be inequitably applied. The estimated annual value of this exemption is $18.1 billion.

Household personal property has been exempt from the property tax since 1871. The annual value of this exemption for 2007 is $352 million.

In 1984, as a competitive response to the elimination of inventory taxes in adjacent states, business inventories were exempted from the property tax. This exemption was phased in over ten years. The estimated annual value of the exemption is $831 million.

Property tax relief for low-income property owners

There are several mechanisms through which low and moderate-income homeowners can gain property tax relief: an exemption, an assessed value freeze, and a deferral of tax due. Property tax exemptions and assessed value freezes are restricted to low income seniors or persons who are retired as result of a disability.

Homeowners who are over the age of 60 or who are disabled and retired are exempt from excess levies if their household income falls below $35,000, and they are exempt from the regular levy on a portion of the assessed value of their home if household income is less than $30,000. For retirees with incomes below $25,000, the exemption is the greater of $60,000 or 60 percent of assessed value. For households with incomes between $25,000 and $30,000, the exemption is the greater of $50,000 or 35 percent of assessed value to a maximum of $70,000.

Nearly 115,000 applicants were approved for the exemptions from taxes due in 2007 under this program. The average relief per applicant totaled $1,466, reducing state and local tax collections by $168 million.

During the 2007 special session lawmakers passed a property tax relief bill that allows all households earning less than the state median income (currently approximately $57,000) to defer up to 50 percent of their property taxes not to exceed 80 percent of the equity of the home. These deferred taxes are due when the home is eventually sold, or when the property ceases to be the permanent residence of the homeowner or a surviving spouse. Interest must be paid on the deferred taxes. The interest rate is the federal rate plus 2 percent (currently equal to 7 percent). The state will reimburse local governments holding them harmless. The state will be reimbursed with interest when the property changes hands.

Property Taxes and the Common Schools

By law, the state must provide sufficient aid to local school districts to fund basic education. As a result, public school spending accounts for over 40 percent of general fund-state spending.

Prior to 1975, though, property owners paid a local regular school levy. The state funded more than half of school operating budgets from general revenues, and the aid to local schools was "equalized" to offset differences in per student tax base between school districts.

In 1975 the regular local school levy was replaced by the regular state levy, and aid to school districts from the state general fund was increased to offset tax revenue loss. To ensure that taxpayers of different counties are treated equitably, the Department of Revenue estimates by county the ratio of assessed to true value; DOR then varies the rate to be applied by the county. The state tax is levied at the rate of $3.60 per $1000 of true and fair value—it's the only component of the regular levy that is levied against true value rather than assessed value. The state property tax is often called the state school levy. The revenues however, are paid directly into the general fund, not into an account dedicated to school funding.

Local school districts are allowed to raise additional moneys for uses that enrich their programs beyond the basic level. These excess levies for maintenance and operations require voter approval, and the dollar amount that any district can obtain is capped. These restrictions are intended to limit a school district's special levy to 24 percent of the district's state and federal revenues. Certain districts are allowed to raise a higher percentage, however, through a grandfather clause. In 2007 voters narrowly approved a constitutional amendment allowing these excess levies to pass with a simple majority (50 percent) rather than the supermajority that had been previously required.

Property Tax Relief Nationally

In 1978 California voters approved Proposition 13, which wrote property tax relief into that state's constitution. The tax rate was capped at 1 percent. Assessed values were rolled back to the 1975-76 levels and increases were limited to 2 percent annually, but with the provision that property would be reassessed at true value whenever it changed hands.

In 1990 Massachusetts voters passed Proposition 2 ½. This both limited that tax rate to 2 ½ percent and limited the annual increase in a jurisdictions levy to 2 ½ percent.

While Propositions 13 and 2 ½ were the most visible property relief measures since the Great Depression, they were, in reality, fairly late events in a wave of property tax reforms that swept the nation in the 1970s. Washington participated prominently in these reforms.

Every state adopted either a homeowner exemption or a circuit breaker. Circuit breakers are state operated property tax relief programs that provide property tax rebates or income tax refunds to low-income homeowners and renters. Homeowner exemptions, on the other hand, exempt a portion of a home's assessed value from the tax and are not means tested. Some states target homestead exemptions specifically at the elderly and disabled; other states make exemptions available to all homeowners.

Washington's system of senior and disabled relief has been described as a mixture of a circuit breaker and homestead exemption.

A number of states also adopted tax rate caps and limits on the growth in property tax collections before California and Massachusetts did. Washington's one-percent limit on tax rates and 106 percent limit on the growth of revenue are prominent examples.

More recently the trend has moved away from focusing on property taxes in isolation and towards controlling overall taxing and spending. In 1979 voters approved Initiative 62, which limited the growth in state tax revenues to the rate of growth in personal income. This did not, however, prove to be an effective constraint. In 1993 voters approved a tougher measure, Initiative 601, which uses a fiscal growth factor to limit the growth in state spending. Originally, the fiscal growth factor was the sum of inflation and population growth, but was changed beginning in 2007 to be the average increase in state personal income for the previous ten years.

Initiative 601 does not constrain local spending, and it is this spending that the property tax primarily funds.