



BRIEFLY

I-722 seeks to limit the growth of government, to constrain increases in property taxes, and to repeal taxes the sponsors' believe were imposed in anticipation of I-695's voter-approval requirement. The attempt is flawed. In particular, the measure violates the principle of property tax uniformity, one of the major strengths of Washington's tax system.

Initiative 722: Wrong Road to Property Tax Reform

Initiative 722, dubbed "Son of 695" by its sponsors, does bear some similarity to last year's successful initiative repealing the state motor vehicle excise tax (MVET) and making tax and fee increases subject to voter approval.

Like I-695, it is a tax limitation measure, tightening the lid on property taxes, and rolling back tax increases adopted by local governments without voter approval between July 2 and December 31, 1999. And, critics have charged the initiative also shares I-695's unconstitutionality.

(As yet, the state Supreme Court has not ruled on a lower court's determination that I-695 was unconstitutional. The legislature repealed the MVET; the voter approval requirement has been suspended pending the Supreme Court's decision.)

Overview

Property Tax Provisions. Four provisions of the initiative would change current property tax law. (A fifth provision, exempting motor vehicles from the property tax, was passed by the legislature last year and is moot.) Generally, I-722 would:

1. Limit the rate of a taxing district's annual increase in property tax collections to the lesser of 2 percent or the inflation rate. State law currently limits increases in total property-tax revenues to 6 percent a year for jurisdictions with populations less than 10,000, and to the lesser of 6 percent or the percentage increase in inflation (the implicit price deflator for personal consumption expenditures) for jurisdictions with populations greater than 10,000. The initiative replaces the 6 percent limit with a 2 percent limit.

2. Limit property taxes for individual properties. For any individual property, the initiative would exempt from taxation any increase in assessed value that exceeds the lesser of inflation or 2 percent. This would not apply to increases due to new construction. For newly constructed property, the initiative exempts from taxation any increment in assessed value over the value of a comparable property in 1999 increased by the lesser of inflation or 2 percent per year.

The assessment lid proposed by the initiative would shift the property tax burden from owners of rapidly appreciating property to owners of slowly appreciating property. The exemption shrinks the property tax base, which will probably lead some local governments – those not at their statutory maximums – to increase tax rates to capture the desired revenues. In addition, the effect of the limit would be to make the property tax more regressive, as properties that have experienced rapid assessment increases in recent years have been those located in higher-income areas around the Puget Sound.

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3. **Repeal the state law allowing jurisdictions to “stockpile” future property-tax increases.** State law currently limits annual increases in property taxes. If a jurisdiction (other than state government) does not levy the maximum amount, it may bank the unused levy capacity for use in future years. I-722 would repeal this provision. Proponents of the “stockpiling” provision say it reduces the incentive for local governments to levy the maximum each year. Opponents argue that it creates the potential for excessive tax increases by local officials.

4. **Amend the “substantial need” statute.** Currently taxing districts may increase property taxes above the inflation limit, up to six percent) by declaring there is a “substantial need” for the money. To do so requires a supermajority vote of the council. I-722 drops the six percent to two percent.

Tax Rollbacks. Initiative 695 would have taken effect January 1, 2000, had it not been ruled unconstitutional in Superior Court. The signatures qualifying I-695 for the November 1999 ballot were filed July 2, 1999. I-722 proposes to roll back and refund all taxes imposed by local governments without a vote of the people between those dates. I-722 sponsors, also the sponsors of I-695, believe that such tax increases were intended to frustrate the intent of I-695 voter-approval requirement.

Fiscal Implications

Property Tax Measures. The two provisions having direct fiscal impacts are the two percent caps on growth in the assessed valuation of individual properties and on the increases in local levies.

State analysts estimate the combined effect on local government will be a reduction in property tax collections of \$106 million for the 2001 calendar year and about \$340 million for the 2001-2003 biennium. They say the reduction results because districts that would otherwise have increased property tax collections by 6 percent will be limited to the lesser of two percent or inflation and because those districts already at their statutory rate limitations will be affected by the lid on growth in assessed valuation.

According to Senate Ways and Means Committee analysts, “most individual taxpayers will pay less in property taxes than they otherwise would.” But, they note, some taxpayers could experience tax increases as a result of the rate increases made to offset the shrinking of the tax base.

As the state property tax is already limited to growth in inflation, about two percent, I-722 will have a limited impact, approximately \$6 million for the remainder of this biennium and \$24 million for 2001-2003.

Tax Rollback. Some local governments did increase taxes and fees before January 1, apparently to avoid having to submit the increases to the voters for approval. An exact accounting of the taxes raised, however, is not available. OFM says no local government raised local retail taxes; some raised excise taxes (the real estate excise tax and lodging tax), “a number” raised property taxes. The agency estimates refunds of about \$0.5 million in excise taxes, \$51.5 million in property taxes, and \$54.9 million in business taxes, fees and permits and service charges. Analysts note, however, that their information is “not complete and comprehensive.”



As with I-695, there is some uncertainty regarding the initiative's application to increases in property tax revenues.

Comments

Critics of I-722 have identified a number of problems with the initiative. It embraces too many issues, they say, violating the Constitution's "single subject" rule, as did I-695. Furthermore, some charge the repeal and refund of last year's tax increases would impose too great a burden on local governments and may also be unconstitutional. (The tax hikes were legal, according to this line of reasoning, so the refunds would be unconstitutional gifts of public money.) Those points, among others, may well be raised in court should the initiative pass. But they are beyond the scope of our review.

The most important public policy question raised by the initiative relates to property tax uniformity, one of the mainstays of our tax system.

The limit on assessment increases for individual properties appears to violate Article 7, section 1 of the state constitution, which says, "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."

Clearly, the initiative would subject properties of equal value to different tax treatment. For instance, suppose the fair market value of two homes is now \$100,000 each, but last year home A was valued at \$100,000 and home B at \$50,000. According to the uniformity provision, both homes should be taxed on their \$100,000 fair market value. But under I-722, home B would be taxed not on the fair market value of \$100,000 but on the taxable value of \$51,000 — \$50,000 plus 2 percent.

Initiative supporters contend that the differential taxation of homes A and B is constitutional. They will point up a different provision within Article 7, section 1: "Such property as the legislature may by general laws provide shall be exempt from taxation."

Several years ago, voters approved Referendum 47, which phased in assessment increases in an attempt to shield property owners from steep hikes in their property taxes, primarily a problem for rapidly appreciating properties (e.g., waterfront or view property). The state Supreme Court ruled that that provision of R-47 violated the Constitutional uniformity requirement.

An analysis of the initiative by staff for the Senate Ways and Means Committee highlights the difference in approaches, saying "... because Initiative 722 specifically 'exempts' value while Referendum 47 'limited' value, the court could uphold Initiative 722 as a valid exercise of the legislative power to exempt property from tax."

It is, of course, difficult to predict the court. Certainly, a ruling accepting the initiative's conceit – a value limit disguised as an exemption – would render the constitutional uniformity requirement meaningless.

If for no other reason, the threat to uniformity makes I-722 the wrong way to approach property tax reform.

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