Property Taxes: Uniformly Low is the Way to Go

Washington state’s property tax system is built upon a constitutional requirement that taxes on real property be uniform. This prevents local governments and the state from setting higher tax rates for business property than for residential property. The result is a tax system in which tax rates are relatively low. A recent study by the Minnesota Taxpayers Association shows that property tax rates in Washington are significantly below the national averages both for residential and business property.

**Uniformity**

The Washington state constitution requires that “all taxes shall be uniform upon the same class of property” and that “all real estate shall constitute one class.” This provision is one of the great strengths of our state’s tax system.

Some states classify real property according to its type or the use to which it is put, with tax rates and assessment standards varying across classes. As the Research Council has noted in the past, non-uniformity in the taxation of property, particularly real property, can hurt business and impede economic growth.1

In states that allow different tax rates for separate classes of real property, voters are able to raise property taxes on business disproportionately without significantly increasing their own taxes. And in these states it is common to see business property taxed at significantly higher rates than owner-occupied housing.

The local business climate suffers. The tax on business property directly reduces the rate of return earned on business investment. Capital is mobile, however, and flows to the locations where the return is the highest. Thus the ultimate effect of an increase in the local property tax is to reduce capital investment in an area. The consequences include higher prices for locally produced goods and services and lower wages for workers.

In Washington state, because of the state constitution, the manifestations of classification have been limited to exemptions for certain types of personal property.

**Effective Tax Rates**

The state of Minnesota has a particularly egregious system of classified property taxes. As a result, the Minnesota Taxpayers Association (MTA) is keenly interested in the issue of classification and has produced a series of studies that document the variation in tax rates on various classes of property across the country. MTA recently completed an update to their **50-State Property Tax Comparison Study**. The update covers taxes payable in year 2000. Earlier
versions covered taxes payable in the years 1995 and 1998.

The tremendous variation in property tax systems across the states makes comparisons of property tax rates difficult. A simple comparison of statutory rates will be misleading. State tax laws differ in their assessment standards. Some, like Washington, specify that property should be assessed at market value. (In practice, assessed values are a bit less than market value.) In other states, the assessed value is supposed to be some fixed fraction of market value. States also differ in the extent that actual assessment practice conforms to the legal standard.

The MTA study focuses on 9 hypothetical properties: two homesteads (owner-occupied homes), three commercial properties, three industrial properties, and an apartment building. The properties vary in the distributions of value among various classes of property, and in the overall values. (See Table 1.) For each property, the study calculates the taxes that would be levied if it were located in the largest city in each of the fifty states. It then calculates for each an effective tax rate, by dividing the taxes paid by the market value of the property.

For example, consider a homestead located in Seattle that includes $150,000 of real property and $50,000 of personal property. Household personal property is exempt in Washington. The real property is assessed at 89.9 percent of market value, for an assessed value of $135,450. At a tax rate of $12.17 per $1,000, taxes due on the real property come to $1,641. Dividing this tax by the $200,000 total value of household property yields an effective tax rate of 0.820 percent.

Table 2 shows, for each of the nine hypothetical properties, the effective tax rate in Seattle, the 51-city average effective tax rate, and Seattle’s ranking among the 51 major cities.

The calculations for Seattle assume a tax rate of $12.17 per $1,000 of assessed value, that real property is assessed at 89.9 percent of market value, and that personal property is assessed at 99.2 percent of market value. Household personal property and business inventories are exempt.

Although real property is taxed uniformly in Washington, effective tax rates do vary because of the exemption of household personal property and business inventories. One quarter of the value of the higher-valued homestead is in exempt household personal property.
As a result, it faces the lowest effective tax rate, 0.820 percent. The lower valued homestead has a higher effective tax rate because relatively less of its value is personal property. The highest effective tax rates are for the commercial properties, 1.113 percent. The rates for industrial properties are lower because of the exemption for inventories.

For each of the hypothetical properties, tax rates in Seattle are well below the national averages. Moreover, the national averages clearly show the effects of classification. The average effective tax rates on business properties are significantly above the rates on homesteads. For Seattle, the business and homestead rates are more nearly equal.

Discussion

Washington’s state and local governments collect an extraordinarily high share of their tax revenues through taxes on businesses. An interstate comparative study by the Institute on Taxation and Economic Policy put business’s share in the state at 50.6 percent, which ranked 4th highest among the 50 states. In light of this, it is particularly important that business property continue to receive the protection from punitive taxation that it is afforded by the principal of uniformity.

Endnotes

