

**A COMMISSION REPORT**

*The Role of the States  
in Strengthening  
the Property Tax*

*Vol. 1*



ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS  
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**THE ROLE OF THE STATES  
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# FOREWORD TO 1975 REPRINT

There are many milestones along the rocky road that the property tax has traveled in the United States. Prominent among them are those marking the creation in 1899 of the Wisconsin Tax Commission, the first state agency with strong supervisory authority in property tax matters; the formation of the National (now International) Association of Assessing Officers in 1934; the first report of the Bureau of the Census on the composition of property tax bases and assessment levels in the several states and many local governments as part of the *1957 Census of Governments*; and ACIR's publication in 1963 of the first printing of *The Role of the States in Strengthening the Property Tax*.

To what extent each of the events that these more prominent milestones memorialize has contributed to advances in property tax administration is indeterminate. Certain it is, however, that great progress has been made since erection of the last of them. This progress is detailed in *The Property Tax in a Changing Environment*, an ACIR publication that records institutional changes in the property tax in the 1963-1972 decade. It is not the purpose of this foreword to recount these details; the avid reader is directed to this recent publication for a recounting. It seems appropriate, however, to enumerate the major areas in which changes envisioned in *The Role of the States* . . . have occurred with enough frequency to be identified as trends.

## ASSESSMENT ORGANIZATION, PERSONNEL AND ADMINISTRATION

**Enlargement of primary assessment districts.** Increasing recognition has been given to the necessity of providing full-time positions for the assessor and at least one appraiser in each assessment district. Minuscule districts that were coterminous with incorporated municipalities and townships (or those portions of townships not within incorporated municipalities) are gradually being replaced with county or large city districts or districts comprised of more than one of the previously independent districts. In three states the ultimate in assessment district enlargement has been achieved by assign-

ment of the assessment function to the state governments.

**Elimination of overlapping assessment districts.** The once prevalent practice of independent assessment of taxable property within municipalities or special districts by two or even more levels of local government has become an anomaly largely confined to the State of Texas.

**Substitution of single-headed for board-headed assessment departments.** A large number of local assessment agencies, and until recently a majority of state agencies performing assessment functions, have been headed by boards. A few of these local agencies and most of those at the state level are now headed by administrators who do not share their responsibilities with peers.

**Creation of independent review agencies whose members do not serve *ex-officio*.** Board of assessors and state tax commissions were created in preference to single directorships mainly because quasi-judicial functions were combined with administrative functions. These quasi-judicial functions, consisting largely of hearing appeals of individual assessments, are now commonly vested in agencies that are divorced (save for housekeeping duties at the state level) from the assessing and assessment supervisory agencies. Moreover, their members are much more likely than heretofore to be persons who are not serving *ex officio* and hence are less intent upon "protecting the tax base" and less likely to pander to the public to insure reelection to office.

**Merit selection of assessors in lieu of election to office without prequalification.** In a growing number but still a minority of states, attainment of the office of assessor requires more than the garnering of a majority of the votes at the polls by a person who has the age, citizenship, sanity, and non-criminal attributes required of the voters themselves. In several states, a candidate for election or appointment must pass a qualifications test. More commonly, a candidate is appointed to office with no formal testing but by officials who should have more concern for qualifications and

better knowledge of the candidates than the electorate can be expected to have.

**Much broader in-service training opportunities for assessment personnel.** The International Association of Assessing Officers, state supervisory agencies, institutions of higher learning, and state associations of assessors have provided a multitude of educational offerings for assessors and their technical personnel. In some states, acceptance of these offerings is mandatory; in others, financial incentives have been established for obtaining the certificates that are awarded to successful participants in the educational programs; and in most, self-improvement is the motivation that fills the classrooms.

**State measurement of local assessment levels.** Very few states today do not require their tax departments to make periodic surveys to ascertain the relationship between the actual assessed value of taxable property and its legally taxable value in various local governmental jurisdictions. This measurement process is performed in some states only for the purpose of distributing state equalization aid to schools. In other states, the ratios are used for a congeries of purposes for which uniformity of assessment levels or offset of assessment level differences is deemed essential to equity in state programs.

**Use of state assessment ratio findings to correct overassessments.** Perhaps the most important, least understood, and least prevalent use of assessment level measurements is to dispense justice to those whose properties are assessed at higher than average percentages of their legally taxable values. One wise in the ways of assessors has said that underassessment is the graveyard in which assessors bury their mistakes. Lacking knowledge of what the properties of others, in the aggregate, are assessed for relative to their legally taxable values, a person whose property is assessed for no more than its legally taxable value does not know whether he is paying more than his rightful share of the tax levies to which his property is subject. The best such a person can hope to do is compare his property's assessed value with the assessed values of similar neighboring properties, a comparison that is unlikely to provide convincing evidence of even egregious overassessment.

**Improvement of valuation techniques.** As recently as a generation ago, appraising was an art and could lay little claim to being a science. Now the field is replete with professional organizations, not the least of which is the International Association of Assessing Officers. Assessors themselves, with a potential data base that private appraisers cannot hope to match, have developed mass appraisal techniques that utilize the capabilities of sophisticated computers to relate a multitude of independent variables with real property sales prices or rentals and thus predict the amounts for which other properties with known characteristics would sell or rent. Thus assessors have both absorbed appraisal lore and extended the boundaries of appraisal science.

## CHANGES IN TAX BASES

No chronicle of property taxation in the last 12 years would be complete without mention of the spread of homestead exemption laws, of programs for the remission of taxes on homes that are deemed excessive relative to household incomes, of inventory exemptions, of the substitution of present use value for market value as the standard for assessment of farm land, and of comprehensive classified property tax systems.

**Spread of homestead exemptions.** With a couple of early exceptions, one of them of very limited scope, the other in a territory that has only recently achieved statehood, homestead property tax exemptions in the United States were depression-borne in the mid-30s. For a time it appeared that their popularity had run its course with the lifting of the Great Depression and that they might even vanish in the prosperous postwar years. Then concern for the apparent regressivity of property taxes revived this moribund institution as *The Role of the States* . . . was in production. This time, again with two exceptions, the exemptions were limited to homes of the elderly or of the elderly and other small groups of presumably needy persons. More often than not, qualification for the exemptions included a means test. The means test in all recent enactments has been based on income rather than on assets, the test that was used in the earliest versions.

**Enactment of circuit-breakers.** More prevalent than homestead exemptions, however, is the circuit-breaker type of property tax relief that was con-

ceived after *The Role of the States . . .* was published. In these programs the amount of relief that is granted to homeowners, or to homeowners and renters, varies inversely with the beneficiaries' household incomes.

**Exemption of inventories.** Another type of exemption has spread with astounding rapidity. Shortly after the termination of World War II, Nevada launched the "freeport" exemption movement which afforded a tax-free haven for goods that were brought into the state, held there with or without subjection to certain processing activities, and then shipped out of the state. Consistent with the adage that one exemption breeds another, the freeport exemption not only spread to other states but gained wider scope, being extended first to goods produced within as well as shipped into the state and then to all inventories or specified percentages thereof whether or not destined for other states. Inventory exemptions may have lessened the pressures for exemption of all personal property, but those pressures have achieved substantially total exemption of this class of property in two states in addition to the four states that had long since constricted the tax base to real property.

**Substitution of present use value for market value standards.** Most surprising of all changes in property tax institutions, however, has been the substitution of "present use value" for market value as the legal standard for assessment of qualifying farm land. Like most of the other changes reviewed here, this change was visible but its profile was low when *The Role of the States . . .* was written. In fact, the two laws of this type that were in effect at that time did not survive the litigation to which they were quickly subjected. Now, such laws are found in nearly four-fifths of the states. The remarkable thing about the rapid spread of these laws is that most of them required constitutional amendments and that the overwhelming majorities of the electorates to which the amendments were submitted live on land that cannot be favored with preferential assessment. Obviously, the advocates of this departure from century-old traditions have succeeded in convincing a large percentage of the populace that lower taxes will save farm land from urbanization.

**Abandonment of uniformity requirements.** One final departure from conventional property tax

molds that has occurred in recent years is a substantial increase in the number of states with comprehensive classified property tax systems. General property tax concepts have been subject to so much attrition in the last quarter century that no two persons are likely to identify the same states as those with comprehensive classification. This writer's count is four such states in pre-World War II days and nine today, including one whose new law has a deferred effective date. In recent conversions, as in many earlier ones, *de facto* classification was traded for *de jure* classification; one other attempt to consummate such a trade was thwarted by the state's highest court, and this state is presumably joining its West Coast neighbors in the search for uniformity by gradual equalization of assessment levels for different types of property.

## SUMMING UP

Without questioning the surviving author, I can only guess how those who wrote *The Role of the States . . .* viewed these developments of the last dozen years. Surely they must have taken great satisfaction in the improvement in assessment organization, personnel, and administration. Being compassionate persons, they were probably comfortable with circuit-breakers and perhaps even with those homestead exemptions which have means tests. One senses, however, that they may have been less than enthusiastic and perhaps down-right unhappy with other developments which narrowed the tax base and exposed it to political manipulation. But they had too much faith in democratic processes, I suspect, to advocate constitutional proscription of recent trends.

This faith has been vindicated by the developments reviewed in the early part of this foreword. While these changes have required an updating of the second volume of *The Role of the States . . .*, they have but emphasized the abiding wisdom of volume one. The eloquence and logic of that volume are lasting tribute to its authors, the late Dr. Frederick L. Bird and his widow, Edna, and a lasting inspiration to those who seek ways in which to preserve the property tax from the oblivion to which it has so often been commended and which it has so stubbornly resisted.

**Ronald B. Welch**  
Sacramento, California  
August, 1975





## PREFACE

This is a report on State-local relations in property taxation. It concerns only a limited aspect of a large, complex and in many respects unique taxing institution. It is one of the oldest and most pervasive of American taxes because it pre-dates the formation of the Union and has been in uninterrupted use since that time. Some 80,000 separate local governmental jurisdictions depend upon it to supply on the average seven-eighths of their tax revenues. While these jurisdictions operate within the constitutional, statutory, and administrative framework prescribed by the 50 States, prevailing practice is infinitely more varied for in virtually all jurisdictions the tax is locally imposed and locally administered.

The Commission's motivation in giving this subject high priority on its work program stems primarily from its key role in State-local fiscal relations. Under our governmental system the primary responsibility for domestic government rests with the States and their local governments. The sharing of these responsibilities between the two levels of government is each State's own determination, which it implements by prescribing responsibilities for functions, assigning taxing powers, and by distributing financial aids to its local governments. Since the abilities of local governments to perform the tasks assigned them and the States' own revenue requirements for supplementing locally raised revenue with State financial aid are so largely dependent on the performance of the property tax at the local level, the States' concern with the quality of that performance is direct and not escapable.

The property tax also has interstate implications, for it weighs in interstate tax differentials and influences the location of industry and the movement of trade across State boundaries. In a very real sense it has an impact on Federal-State relations as well, because it affects the capacity of the States with their local governments to provide essential governmental services at levels compatible with the national interest and therefore affects directly the need for Federal grants and other financial aids to State and local governments.

In short, the Commission views the States' opportunity to strengthen the property tax an opportunity to strengthen our federal form of government.

#### PREFACE

This report was adopted at meetings of the Commission held on March 22 and June 27, 1963. It is being issued in two volumes: Volume 1 contains the Commission's recommendations and analysis of the problem and Volume 2 contains a State-by-State review of recent developments in property tax policy and administration.

FRANK BANE, *Chairman.*

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In conformity with established practice, a preliminary draft of this report was placed for searching review and criticism before a conference of critics, composed of nationally recognized experts on property taxation and government administration. The participants included:

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L. L. ECKER-RACZ,  
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# **PART I**

## **INTRODUCTION AND RECOMMENDATIONS**





## Chapter 1

### INTRODUCTION

This is not a report on the property tax. Its scope is more limited: an exploration of State responsibilities respecting the tax—what the States have neglected to do, are trying to do, and can do to rehabilitate this important source of (primarily) local government revenue in the many areas where weak and inequitable assessment administration has harmed both its usefulness and its reputation.

That gross inequalities in assessing are widespread is universally recognized. This condition is so ancient that it tends to be taken for granted as an inherent characteristic, and State and national studies keep reaffirming its continuance. Over the past 50 years notable advances have been made in the organization and methods of State and local fiscal administration, but in very many areas assessment administration has not kept pace with this progress. This failure is particularly conspicuous because the experts have long known how to get good assessing and a minority of local assessment districts have used this knowledge to produce very acceptable results.

The maintenance of a satisfactorily high quality of assessment administration in a considerable number of assessing areas encourages the belief that it can become universal if the States so desire. Yet the States are facing an embarrassing dilemma. They can ill afford any weakness in a tax that supplies nearly one-half of all State-local tax revenue, but they are reluctant to take the necessary steps to make the tax as strong as

it should be. State policy makers have been finding, to their disconcertion, that relinquishing the property tax for local use extinguishes no State responsibility, since the State governments have to fill local as well as State revenue gaps. Traditions of local home rule, however, have been a restraining force, or at least an excuse for State inaction; although the concept of home rule as a license for any local community to stultify its chief source of revenue support could spell the ultimate demise of local self-government.

A tax as ancient as that on property tends to become an institution and to accumulate fondly clinging traditions as it evolves over the years. Certain concepts more admired a hundred years ago than now found their way into State constitutions from which some States have not yet been able to extricate them, and rudimentary methods of administering the tax that worked only fairly well in colonial days are still cherished in some areas with what has been described as "a touching though misplaced fidelity." Since rehabilitation of the property tax involves a challenge of some of its institutional idiosyncrasies, their identification may be useful.

Most of the treasured relics of pioneer days are in museums, but the antiquarian instincts of some of our State legislatures are so strong that in many areas they have been successful in preserving almost intact the organization and conduct of primitive fiscal administration as it relates to prop-

erty tax assessment. The theory appears to be that the absence of a workable organization and of a professional personnel at the local level can somehow be offset by superimposing a hierarchy of regulatory agencies for the provision of guidance and correction of mistakes. To prevent the complete disintegration of the ancient system, the procedure is to bring in skilled technicians periodically for a "reevaluation," following which there is a new cycle of deterioration. Fortunately enough, there also have developed, here and there, well organized, well staffed, well equipped establishments for scientific property assessment that point up the requirements for its extension.

A somewhat exclusive characteristic of property tax administration is that few officials feel under obligation to enforce the tax law as written. In some States, in fact, compliance by the assessors with the constitution and statutes would be a cause for general consternation. The average assessor makes himself a sort of one-man legislature. He—not the State constitution and the State legislature—defines local taxing and borrowing power and determines the value of a veterans' or homestead tax exemption by the level at which he decides to assess property. He is likely, also, to administer his own version of the personal property tax. A variation of such procedure is for a State administrative agency to interpose its determinations, likewise often without much relation to the provisions of the law. Without doubt such practices breed disrespect for the tax law, but the law itself may be entitled to disrespect. Thus the corrective, at least in part, is a tax law that is administrable and legal procedures for enforcement that are clear and effective.

The predilection of State legislatures and constitutions for assessed valuation as a measuring stick is one of the strange phenomena surrounding the property tax. It would be hard to think of a more erratically elastic standard for measurement purposes, yet it is applied by most States, apparently with the utmost confidence, to make scores of varieties of determinations that call for some degree of precision. This favored standard has almost unique attributes, in that it has no clear and uniform value to begin with, varies in value from time to time, and varies in value from one local assessing district to another. In recent years numerous States have been trying, through various equalizing devices, to give some reliability to these rubber yardsticks, but such efforts often have distracted attention from the more important goal of greater reliability in primary assessing.

The State legislatures appear to view the property tax as a modern replica of Amalthea's fabulous cornucopia, capable of pouring out subsidies and benefits for an ever-widening variety of favored recipients. Having discovered property tax exemption as a means of making lavish contributions to worthy private causes, satisfying welfare needs, showing public esteem, and befriending politically influential pressure groups—all without the necessity for budget appropriations, accounting, or apparent cost to the State—the legislatures quite understandably have preferred this course to that of making grants and levying taxes to support them. For the steadily narrowing group of taxpayers who have to foot the bill the procedure is less inviting, and people who have a disagreeable propensity for trying to look ahead are beginning to wonder what happens when the horn runs dry.

Once upon a time the State governments

depended mainly on the property tax and depended entirely on local governments for its administration, but for over a hundred years the administration of the tax has been a joint responsibility of State and local governments. This two-level management of one tax obviously has its problems—such as how to apportion responsibility, how to coordinate efforts, how to assure professionally qualified personnel at both levels and their use of uniform standards, and what to do about some kind of overall control. The States have worked at these problems spasmodically, but not many have achieved even a reasonably tenable solution and only a few are close to having the situation well in hand. Whether the ultimate solution is well-coordinated, thoroughly professionalized joint administration, or centralization of the assessment or entire administrative function remains to be determined.

One of the special problems of organization is that of how to align the interests of the large, self-sufficient local assessment districts with those of the State regulatory agency and of the State as a whole. Since the large district, if it has developed efficient performance, probably has done it without much help from the State or even has been handicapped by some archaic feature of the tax law, it probably feels little identity with any State promoted program for statewide progress. That there is an underlying mutuality of interest, however, is disclosed by some of the problem features of the property tax that have been noted.

State-local government needs the property tax, and needs it free and clear of administrative defects that mar its reliability and respectability. What position it should occupy in a State-local revenue system, however, is a matter each State must determine for itself, though not on the basis of

prejudice, pressure group influence, or the discredited doctrine of separation of revenue sources, but in respect to its appropriate place in a well-balanced overall revenue structure. Because the demands for revenue at both the State and local levels are bound to increase, the property tax will have to contribute its reasonable share of the total. Its share will be less burdensome, however, if the States can (1) eliminate unjust features of the tax law, (2) eliminate unequal assessment, and (3) recognize intercommunity differences in fiscal ability and devise better means for equalizing the burden.

All but a very few States are working on specific projects or programs to upgrade the property tax and its administration.<sup>1</sup> Some of these undertakings lack the wholehearted legislative and executive backing that they need and some of them are trouble-shooting efforts that lack broad, basic goals; but the virtual unanimity of the movement and its concentration on constructive action are encouraging. Most of the programs are concerned primarily with some or all aspects of the assessment problem, and some of them, by their forthright and systematic approach, definitely brighten the prospects of the property tax.

Upgrading assessment administration, it must be said, means vastly different things in different States, for at present the States are cons apart in their management of this function. At one extreme, in a State with long-established leadership in assessment methods, the State tax department may be engaging in advanced valuation research; at the other extreme, just as significantly, a State may be undertaking for the first time

<sup>1</sup> Most of these undertakings are summarized in vol. 2.

to find out systematically how bad local assessing is, and why. Regardless of the level from which the improvement has to start, one of the most encouraging features of the new movement for bettering property tax assessment is the increased reliance in State supervisory agencies on scientific methods and statistical techniques for measuring and comparing the quality of assessing. The facts that emerge are persuasive evidence of the need for the movement to continue.

The changes in policy and method that are prerequisite to strengthening the property tax would appear, at first glance, to involve nothing more than the application of common sense and the fundamentals of good management; but this disregards such evasive obstacles as the stake of many interests in the status quo, the antipathy to departure from familiar traditions, and the proverbial "incredulity of mankind." Thus

spasmodic efforts will produce little. The only formula that has much chance of success is a well devised program backed by leadership, courage, and perseverance.

A look at the States that are out in front in this movement discloses that they have had the advantage of a substantial share of the following ingredients: a talented, determined State tax commissioner or commission making convincing use of sound technical knowledge not only to formulate the program but to gain receptive public interest; a governor with sufficient appreciation of the importance of the issue to appoint well-qualified commissioners and give them strong backing; a legislature well fortified by continuing tax study committees and competent research aid to give the undertaking its intelligent support; and the cooperation of State and local civic leaders, public and private, in a program of public education.

## Chapter 2

### CONCLUSIONS AND RECOMMENDATIONS

The issues at stake in the future of the property tax are sufficiently important to give to clarification of the position of the tax and to the standardization of its administration high priority in the fiscal programs of the States. A more equitable deal for the individual property taxpayer and greater self-governing security for the scores of thousands of local governments dependent on the property tax are in themselves adequately impelling reasons for the States to concentrate on these objectives; but as an additional consideration, there is the key role played by the property tax in intergovernmental affairs. While it is easy to think of the property tax as a local tax and to overlook its intergovernmental implications, such features as the composition of the tax base, the accuracy with which it is determined, and the scope of and restrictions on its use are influential factors in interlocal, State-local, interstate, Federal-State, and Federal-local fiscal relations.

Strengthening the property tax calls for intergovernmental cooperation, but there are some things that only the States can do. These special State responsibilities stem from the nature of the State's jurisdiction and legal authority—they rest in areas in which only the State has adequate power to act. For much of what needs to be done the legislature and the governor have ample authority; but in many States certain key features respecting the nature, use, and administration of the property tax have been

interred in the constitution, circumscribing legislation, and complicating alteration.

The question of what these State responsibilities are is in the process of being answered more clearly and realistically than ever before as the States move ahead with their present widespread efforts to rehabilitate the property tax. Interviews and correspondence with more than 200 persons in most of the States who are directly concerned with the formulation and administration of these programs or are qualified professional observers have educed a marked consensus on the general lines of action which the States must follow to obtain worthwhile results. Allowing for wide differences in existing conditions among the States and considerable variations in opinion as to the relative importance of the several lines of action and the methods to be followed in promoting them, there seems to be rather general agreement that the basic State responsibilities are as follows:

1. To know precisely and continuously what the property tax situation is throughout all taxing and assessing districts of the State, with respect both to the utilization of the tax and the quality of assessing, and to make well analyzed and clearly informative data on these features regularly available to the public.

2. To amend or change property tax laws that are inequitable, unworkable, unduly restrictive, or otherwise unsatisfactory. This applies equally to laws which deter-

mine the tax base, establish limitations and exemptions, and set forth the procedures for administering the tax.

3. To determine the appropriate role of the property tax in a well-integrated State-local revenue system and to guard against any grossly unequal distribution of the property tax burden.

4. To recast any features of the administrative setup that prevent efficient, equitable administration. This responsibility relates to both organization and personnel.

5. To provide effective State supervision and coordination of property tax administration.

6. To provide the taxpayer with readily usable and effective means of protecting himself against inequitable assessment.

To discharge all of these responsibilities well would be a large order for any State, particularly since some involve highly controversial issues; but they do define the basic framework for the kind of broad program that is necessary to cope with this perennially baffling tax problem. The prevailing circumstances in many States are likely to dictate a piecemeal approach to assumption of full State responsibility for the wellbeing of the property tax; but such an approach is due to have disappointing results unless it is undertaken with a broad program in view and each piecemeal effort is a well-designed segment of the whole. Because the successful accomplishment of a long-range program is dependent on the kind of informed and pertinacious continuing leadership in both the legislative and executive branches that is hard to come by, a State would be fortunate indeed if it could formulate, adopt, and place in operation as a single comprehensive project, all of the main essentials of an adequate plan.

Parts II and III of this report examine

the major problems of property tax policy and administration, the States' relation to them, and the possible means for the States to deal with them, while Volume 2 summarizes the various lines of action which the individual States are taking to meet their property tax responsibilities. The following recommendations for State action, amplified in subsequent chapters, are based to a large extent on the definite accomplishments of some States and the significant features of programs that are underway in other States; but they also take account of the failure of half-way measures, indifferently enforced, to achieve needed results.

## RECONDITIONING THE TAX LAWS

### *Need for a Manageable Tax Structure*

To facilitate improvement in the administration of the property tax, the tax law itself needs to be made more administrable. What classes of property should be taxed is a question for each State to decide for itself on the basis of all appropriate criteria, but with feasibility of administration an important consideration. Ad valorem taxes on most classes of property, real and personal, can be administered with reasonable competence if a State is willing to provide suitable means; but the extent to which some personal property tax laws have become legal fictions is notorious. Evasion and the condoning of evasion are so widespread as to make such laws a tax on integrity. Regardless of whether this condition stems from injustices inherent in some of the tax provisions or from administrative incompetence, it creates for the property tax system an unhealthy disrespect.

*Recommendation No. 1. Each State should take a hard, critical look at its property tax law and rid it of all features that*

*are impossible to administer as written, whose effective administration would be economically intolerable, which force administrators to condone evasion, and which encourage taxpayer dishonesty. To protect the integrity of its tax system, no State should retain in its property tax base any component that it is unwilling or unable to administer with competence.*

In some States the modernization of property tax systems and their administration is hampered by constitutional provisions that are archaic, confusing, or cluttered with details of a statutory nature and are often difficult to amend.

*Recommendation No. 2. To give legislatures and governors flexibility and responsibility for producing and maintaining equitable, productive, administrable property tax systems, constitutions should be divested of all details that obstruct sound utilization and administration of the property tax.*

Classification and exemption are potentially useful legal devices for making property tax systems more readily administrable; but in some States a long accretion of piecemeal modifications, some of them representing merely capitulations to influential pressure groups, have complicated administration by adding needless minutiae to the assessor's job without compensating advantages for the tax system.

*Recommendation No. 3. No new changes in the property tax system, whether by exemption or classification, should be undertaken without weighing the effect on facility of administration, and where administration has been needlessly complicated by such changes in the past, the defects should be eliminated wherever it is feasible to do so.*

The efficiency and fairness with which the assessor performs his job depends heav-

ily on the clarity with which the law defines his duties and on his being given powers that match his responsibilities. That property tax laws setting forth definitions, procedures, and powers should accumulate archaic, conflicting, and nonworkable provisions is a natural result of their long evolution. In the field of personal property taxation it is the exception rather than the rule for the assessor to be given the authority he needs to discover and appraise taxable property.

*Recommendation No. 4. In any State where the laws governing assessment administration have not been carefully reviewed and recodified in recent years and where ambiguities, inconsistencies, and other weaknesses have developed, the laws should receive a thorough reexamination, overhauling, and recodification.*

*In the instance of any class of self-assessed personal property, unless the local assessor is given adequate means to audit the declarations of the taxpayers, the property should be assessed by the State or the tax on such property abolished.*

#### *Eliminating Underassessment and Effectuating State Fiscal Regulation*

While inequitable assessment is the most serious defect in property tax administration, underassessment can and often does have such widely detrimental effects that it also must be eliminated. Underassessment exists when assessors assess property at levels below that legally required by constitution or statute, as is the common practice in most States. As further complications, the degree of underassessment usually varies widely among the local assessment districts within a State and the basis used by the State agency for assessing centrally

assessed property may be different from some or all of the local bases.

Despite this anarchic condition, assessed valuation is used by the States as a base for numerous important regulatory purposes, including those limiting the taxing and borrowing powers of local governments and determining the amounts of tax exemption for veterans, homestead owners, etc. Whatever the firm regulatory intent of a constitution or statute may be, it is distorted variously throughout the State by these assessment practices. Assessed valuation also has been used widely as a base for the distribution of State school aid in such manner as to compensate for intercommunity differences in fiscal ability. With this policy stultified by interarea variations in the extent of underassessment, the States have been turning to various methods of interarea equalization of assessment levels. This may solve the school aid problem; but when the State administrative agency assigned to this function equalizes assessments at a level below the legal requirement it, like the local assessor, usurps legislative authority in all regulatory determinations for which assessed valuation serves as a base.

The States have a choice among three possible courses of action to eliminate underassessment and its distortion of all related State regulation. (1) They can provide for effective enforcement of existing law. (2) They can change the law to conform more nearly to prevailing assessment practice and then concentrate on effective enforcement. (3) They can adopt the following alternative procedure: First, abolish fixed assessment levels (subject to the enforcement of a specified minimum level of assessment), giving the assessor a flexible range of action, but requiring the State supervisory agency to determine an-

nually by assessment ratio studies the average level of assessment in each assessment district and to supply this information to the taxpayers. Second, for use as a regulatory and measurement base, replace assessed valuation by the market value of taxable property as determined annually by the State supervisory agency.

The third course is the most satisfactory. In the first place, the assessor is divested of his extralegal regulatory power and is able to concentrate on his basic responsibility of obtaining reasonable uniformity in assessing without having to achieve this uniformity at some fixed level specified by law. In the second place, the use of State determined market value as a base for regulatory and measurement purposes permits the laws enacted for such purposes to carry a firm expression of their intent and to apply uniformly on a statewide basis. However, since market value can itself be interpreted in different ways, the interpretation intended needs to be more clearly indicated. In the third place, the taxpayer, by being kept regularly informed of the average level of assessment, is better situated to protect himself against inequitable assessment. Under the foregoing procedure the level of assessment no longer influences such factors as borrowing and taxing power; but since the quality of assessing apparently tends to deteriorate at low levels of assessment, the requirement of a minimum level set as high as practicable is a prudent policy.

*Recommendation No. 5. The States should eliminate all constitutional and statutory requirements for fixed levels of assessment except for specifying the minimum assessment ratio (in relation to market value) below which assessments may not drop, and use for equalization and measurement purposes the annual assessment ratio*



studies conducted by their State supervisory agencies, as follows:

(a) *The determined average level of assessment in each of a State's assessment districts would provide the basis for tax equalization in taxing districts located in more than one assessment district and for equalizing State grants for schools and similar purposes.*

(b) *The determined figures for the market value of taxable property in each taxing district would be the base for all regulatory and partial tax exemption provisions now related to assessed valuations or valuations equalized at fractional levels.*

*Recommendation No. 6. In conjunction with adoption of the foregoing course of action, a State should conduct a thorough re-evaluation of all regulatory and partial tax exemption provisions that have been related to assessed valuation, consider the desirability of their continuance from the point of view of sound policy, and for any that may be continued, make such adjustments as are called for by the new market value relationship.*

*Recommendation No. 7. Because there is a tendency for nonuniformity of assessment to increase when property is assessed at low fractions of full value, it is important to use as high a floor as is feasible in setting minimum assessment levels.*

#### *Restraining the Property Tax Give-Away System*

The States have long had a propensity, which is continuing, to fritter away the property tax base by concealed subsidies in the form of special tax exemptions to promote private causes of questionable public importance, provide welfare aid, advance undertakings for social and economic reform, and reward public service. Typi-

cally these special tax exemptions are mandatory upon local taxing jurisdictions; they have to be honored by them, regardless of their revenue cost or the preference of the particular community. The utilization of exemption from property taxes without regard for the secondary effects thereof has advanced so far in redistributing the property tax burden that a re-examination of this device is needed.

The indirect subsidies thus conferred on various taxpayers do not appear on a State's budgets or accounting records, and thus tend to receive approval with much less scrutiny than appropriations for the same purpose would be subject to. They appear, in a bookkeeping sense, to be without cost to the State and local governments; they do, in fact, impose a forced expense on the taxpayers to whom the burden has been shifted, complicate the work of the property tax administration, and progressively weaken the property tax system.

*Recommendation No. 8. In order that the taxpayers may be kept informed, each State should require the regular assessment of all such tax exempt property, compilation of the totals for each type of exemption by taxing districts, computation of the percentages of the assessed valuation thus exempt in each taxing district and publication of the findings. Such publication should also present summary information on the function, scope and nature of exempted activities.*

*Recommendation No. 9. Outright grants, supported by appropriations, ordinarily are more in keeping with sound public policy and financial management, more economical, and more equitable than tax exemptions and should be used in preference to the latter, with allowance for such exceptions as are clearly indicated by the public*

*interest. No tax exemption for secular purposes should be initiated or continued which would not be justifiable as a continuing State budget appropriation.*

*Recommendation No. 10. In the instance of mandatory tax exemptions extended to individuals for such purposes as personal welfare aid and expressions of public esteem, the States should reimburse the local communities for the amounts of the tax "loss."*

### THE PLACE OF THE PROPERTY TAX IN THE STATE-LOCAL TAX SYSTEM

In recent decades the great majority of the States withdrew largely or entirely from State use of the property tax. This development added materially to the tax resources of local governments but also created a new problem and left an old one unsolved. The new problem was how to overcome the tendency of the States to skimp their share of property tax administration. Many legislatures were reluctant to appropriate funds for the administrative supervision of a tax that produced little or no State revenue, seemingly oblivious of the fact that weakening of the property tax through local mismanagement would increase the demand for State fiscal aid from other revenue sources.

The unsolved problem was how to moderate the uneven distribution of the property tax load throughout the State. The States' widespread relinquishment of their use of the tax provided more local revenue, but with a distribution that gave more to the affluent and less to the needy community. As the cost of local government increases, it emphasizes the fact that the relation between local taxable resources and local government needs tends to vary widely among

a State's communities, making the property tax burden abnormal for some and subnormal for others.

While complete statewide equalization of the property tax load would be impractical and undesirable, moderation of gross inequalities arising from unequal fiscal abilities is a State responsibility that requires increasing attention. First, statewide dependence on the property tax tends to be strengthened by elimination of scattered peak-tax-load trouble spots. Second, every State is under the necessity of maintaining statewide minimum standards for certain vital local public facilities and services despite the fiscal inability of some areas. Third, leaving this problem for attempted solution by local governments merely adds to its ramifications, since local governments resort to protective devices that tend to generate more, rather than less, inequity. They carry on interlocal economic warfare through competitive underassessment; they help to create tax havens for concentrations of industry; and small suburban communities engage in protective planning and zoning that may be a deterrent to sound land use planning for the well-balanced economic development of the metropolitan areas in which they are located.

How to modify these inequalities has received some attention in numerous States, notably by such means as shifting local functions to broader jurisdictions (such as consolidating school districts), developing compensatory aid programs (mainly foundation school programs), and, in a few States, levying a statewide property tax for local use.

The levy of a statewide property tax for local use would aid in the solution of the problems summarized above, for it not only would give the States a stronger interest in

the status of the property tax, but should tend to lessen local resistance to the States' proper exercise of their authority to regulate local tax administration. Moreover, use of the State as a taxing district for the levy of a tax, on the State determined market value of all taxable property, for distribution to local governments in such manner as to help equalize the cost of providing basic local services at required standards would have an automatic tax-equalizing effect, limited, of course, to the scope of the State tax.

Whether or not the property tax is used for State purposes, it requires an established position in State financial planning. Since the State and its localities share one governing job, with the State responsible for determining the local share of this role and providing adequate means for its financing, State financial planning necessarily must be in terms of the overall revenue structure. If the concentration is on State purpose revenue with local revenue needs receiving only emergency attention from time to time, there is likely to be no carefully weighed, clear determination of the appropriate role of the property tax in the overall revenue system, and decisions will tend to be made on the basis of popular prejudice and the efforts of self-seeking pressure groups.

*Recommendation No. 11. Both the legislative and executive branches of the State governments should study the property tax as consistently as the other major sources of State-local revenue and treat it as an integral part of overall State and local financial planning. Adequate provision should be made for continuing study and analysis in the research divisions of State tax commissions and tax departments and by the interim tax study committees, legislative councils, and legislative reference bureaus*

*of State legislatures, with workable liaison arrangements.*

## ORGANIZING FOR EFFECTIVE ASSESSMENT ADMINISTRATION

State responsibilities include not only the provision of an administrable tax but the means for its efficient and equitable administration. By far the most difficult and decisive function in the administrative process is the assessment of property for tax purposes. The conduct of this function is acceptable only when there is reasonable uniformity of assessment in all assessing districts throughout a State, both within and among all classes of taxable property. To safeguard the future of the property tax, all States face the necessity for raising the statewide quality of assessment to the high standards demonstrated to be feasible in some assessing areas.

The achievement of this goal is primarily a matter of personnel, organization, and equipment. Once there is recognition that the assessment of property for taxation is a technical administrative function which can be performed competently only by well trained specialists using all of the appropriate tools and techniques, the prerequisites for success in any State become inescapably clear. The solution of the assessment administration problem calls for professionalization of the assessment function and development of an administrative organization within which the professional staff can work effectively and which permits efficient statewide coordination.

There are three possible methods of organization:

1. Complete centralization of property tax administration, with each local government levying the amount of taxes that it

wishes and the State providing professional services for administering the tax.

2. Complete centralization of assessment administration, with the valuations certified to local officials as the basis for their billing and collection of taxes.

3. Well coordinated joint State-local administration.

The first alternative is followed presently by Hawaii. The second alternative has received consideration in a few States but none has as yet adopted it in full. Joint State-local administration is the prevailing procedure in most States, with coordination that meets with varying degrees of success. State assessment of all property, with more inclusive centralization when dictated by the advantages of central data processing methods, offers sufficient potential benefits to justify serious consideration of its adoption by every competently governed State. The alternative—continuation of joint State-local assessment administration—needs drastic modernizing and strengthening to make it work well.

Any State which has demonstrated competence in its general State administrative organization and performance should be able to conduct the assessment function with satisfactory results; but the agency designated or created for this purpose should have stature in the State's administrative organization that conforms with the importance and high professional requirements of the job, and should have the same kind of organization and control that safeguards the integrity of the other well organized, professionally staffed, skillfully directed administrative agencies of the State. For assurance of continuing high-quality performance the agency should be required to publish clearly informative statistical evaluations of the quality of its work, which

also should be subject to periodic independent audit.

*Recommendation No. 12. Centralized assessment administration, with more inclusive centralization when dictated by efficiency, should be considered for immediate adoption by some States and for ultimate adoption by most States. It offers an uncomplicated and effective means of obtaining uniformly high-standard assessing throughout a State by the use of an integrated professional staff following standard methods and procedures under central direction.*

#### *Improving Joint State-Local Administration*

States not prepared to move toward centralized assessment administration will generally find substantial scope for strengthening their system of joint State-local administration. The continuance of mediocre to poor assessing in wide sections of the Nation discloses that there is something wrong with the century-old system. Most of the recent efforts to improve the quality of property assessment have concentrated on making the joint system work better. To knit this two-level system into a well-coordinated smoothly-functioning organization is a baffling undertaking, but it appears to be feasible if a State is willing to recognize the prerequisites and follow them faithfully. The resulting operation, however, will be more complicated and difficult to manage than a system of complete central assessment and it will have to desecrate almost as many sacred traditions as would the adoption of the latter system.

The prevailing pattern for State-local property tax administration, subject to innumerable variations, is (1) an aggregation of local assessment districts responsible for

the bulk of the primary assessing; (2) usually an aggregation of local or county boards of review; (3) sometimes an aggregation of county boards of equalization; and (4) a State agency or agencies responsible variously for supervision of local assessing, provision of technical aid to local assessors, hearing taxpayer appeals, interarea equalization of assessments, central assessment of some classes of property, and valuation research.

These systems are worthless and a waste of money unless they produce primary assessing of all taxable property with a reasonable degree of uniformity. No State can hope to achieve this goal unless its system meets substantially the following requirements for good administrative management:

1. A well-coordinated State-local administrative organization with a central directing authority.

At the State level the requirement is for the State's share of the administrative responsibilities to be vested in a single agency professionally organized and equipped for the job, with adequate powers of supervision and regulation clearly defined by law.

At the local level the requirement is for assessment districts so organized and staffed as to make competent local assessing feasible and the setup efficiently regulatable. There needs to be sufficient integration of the two levels to produce good teamwork.

2. A completely professionalized assessment personnel, with compensation and opportunity for advancement adequate to attract and hold qualified people.

3. A workable apportionment of two-level assessment responsibilities, with careful coordination of assessment standards and procedures.

### *Recommendations for Organization*

*Recommendation No. 13. The geographical organization of each State's primary local assessment districts should be reconstituted, to the extent required, to give each district the size and resources it needs to become an efficient assessing unit and to produce a well-ordered overall structure that makes successful State supervision feasible.*

*No assessment district should be less than countywide and when, as in very many instances, counties are too small to comprise efficient districts, multicounty districts should be created.*

*All overlapping assessment districts should be abolished to eliminate wasteful duplication of work.*

*Recommendation No. 14. The State's share in joint State-local assessment administration should be vested in a single agency, professionally organized and equipped for the job, and headed by a career administrator of recognized professional ability and knowledge of the property tax and its administration.*

*In States in which tax administration is coordinated in a central tax department, the agency should be a major division of that department; in States where organization for tax administration is diffused, the agency should be given due prominence as a separate department or bureau. Under the latter condition, particularly when strong central executive control is lacking, it may be desirable to have the career administrator serve under a multi-member commission appointed for overlapping terms.*

*The agency should be responsible for assessment supervision and equalization, assessment of all State assessed property, and*

*valuation research, with adequate powers clearly defined by law.*

Under the organization recommended above, and with the professionalizing of appraisal personnel and concentration of the functions of supervision and equalization in a central State agency as proposed in the following sections, there is no place for separate ex officio or otherwise constituted local and county boards of review and boards of tax appeals or county and State boards of equalization serving administratively as part-time supervisors. Effective agencies, however, will continue to be needed to satisfy the taxpayer's right to a hearing under due process of law.

#### *Professionalization of Personnel*

Given a statewide pattern of assessment districts that meets the foregoing standards, there remain problems of administrative organization and staffing. The local assessment agency may be a department or bureau in the administrative structure of a county government or an agency of a multicounty assessment district. Heading the agency is the assessor, with a small staff in an agency of minimal size, a sizable and complex staff in a large agency. Irrespective of the size of the agency, the assessor and his appraisal staff must be professionally qualified for their responsibilities.

*Recommendation No. 15. The State supervisory agency should be empowered to establish the professional qualifications of assessors and appraisers and certify candidates as to their fitness for employment on the basis of examinations given by it or of examinations satisfactory to it given by a State or local personnel agency, and to revoke such certification for good and sufficient cause.*

*No person should be permitted to hold the office of assessor or to appraise property for taxation who is not thus certified.*

*Recommendation No. 16. All assessors should be appointed to office, with no requirement of prior district residence, by the chief executives or executive boards of local governments when assessment districts are coextensive with such governments and by the legally constituted governing agencies of multicounty districts; they should be appointed for indefinite, rather than fixed, terms; and should be subject to removal for good cause, including incompetence, by the appointing authorities.*

Professionalizing the assessing function means more than making positions appointive and requiring qualifying examinations and certification. The work is challenging to persons of ability, but to be able to recruit and hold such people it must be made professionally attractive by adequate salaries and opportunity for advancement in compensation and responsibility. Statewide professionalization, with opportunity to move upward to the highest posts in the State-local system, offers a good foundation.

*Recommendation No. 17. To avoid obstruction to the local recruitment and retention of competent professional personnel, the State legislatures should not set, or place limits on, salaries paid certified local assessors and appraisers.*

A local assessment district, in order to function competently, must have not only a trained staff but an adequate staff, measured by the scope and character of its assessing responsibilities. In instances where the services of a special technician are needed, but not on a full-time basis, the district may be able to meet the situation most economically and efficiently by retaining the part-time or temporary services of a specialist on

the staff of the State supervisory agency on a service-at-cost basis.

*Recommendation No. 18. The State legislature should prescribe, or authorize the State supervisory agency to prescribe, and in either case authorize the agency to enforce, minimum professional staffing requirements in all local assessment districts; and the legislature should authorize the supervisory agency and any local district to enter into agreements under which the agency will provide the district with specified technical services.*

The cost of the efficiently organized and professionally staffed system for joint State-local assessment administration recommended above will tend to be higher than that for most State supervisory agencies and the great majority of local assessment districts as presently constituted. This is a price that must be paid for rehabilitating the assessment process in the many areas in which it is undependable and unjust, but there should be more than offsetting compensation in the strengthening of State and local government and more equitable treatment of taxpayers.

#### *Apportionment of Assessing Jurisdiction*

In the great majority of States some property is State assessed, mainly the operating property of public service enterprises and various types of intangibles, but in some States also mines, minerals, timber, industrial plants, business tangible personalty, and the like. Under any well devised system of joint assessment administration, the division of responsibility for assessment of the several classes of taxable property would be based on principles of efficiency and economy, and would be drawn clearly to avoid confusion and uncertainty. We are here concerned, it should be remembered, with

the division of responsibility for assessing property and no inference is intended with respect to the distribution of revenues from property taxes.

Among the classes of property which are more suitable for central than local assessment are: property of a type customarily located in more than one local assessment district that does not lend itself to piecemeal appraisal, such as public utilities; complex properties of material value but of insufficient number in some or all local districts to justify the local employment of full-time appraisal specialists, such as mines, oil and gas wells, possibly industrial plants; properties for which the central agency, because of its more ready access to the data of State and Federal regulatory and fiscal agencies, and other similar reasons, is better situated to discover and value, such as intangibles, some classes of business tangibles, and migratory property constantly moving in and out of the State; and properties having a statewide standard of value which are readily discoverable by the central agency, obviating needless duplication of appraisal (for example, whiskey stored in bonded warehouses, centrally assessed in Kentucky and Maryland).

*Recommendation No. 19. State assessment should be extended to all property of types: (1) which customarily lie in more than one district and do not lend themselves to piecemeal local assessment; (2) which require appraisal specialists beyond the economical scope of most local district staffs; and (3) which can be more readily discovered and valued by a central agency.*

Any blurring of the allocation of assessing jurisdiction contributes to administrative disarray and may either confuse the taxpayer, add to his cost of compliance, or give

him opportunities for evasive tactics. Such conditions tend to develop when, instead of allocating responsibility for all property of a type, distinction is made for such factors as size, or components of the same property are divided for State and local assessment.

*Recommendation No. 20. The division of assessment jurisdiction between State and local agencies should be clear both to taxpayers and assessors.*

### EFFECTIVE STATE SUPERVISION AND COORDINATION

Any widely decentralized operation needs central supervision and coordination to produce a uniformly standard product. Even if a State has a geographically efficient local assessment district organization, with each district adequately staffed with professional personnel, the key to uniformity of assessment on a statewide basis is a capable central supervisory agency with all appropriate powers and facilities. If the local arrangements are not all that they should be, the State needs a strong central agency to do the best it can with what it has to work with and to help plan ways and means of improving the existing setup.

In working toward the goal of good-quality assessment on a statewide basis, any State and its supervisory agency are fortunate if there are some local assessment districts already meeting high standards and an association of local assessors with truly professional objectives. Under these conditions reasonable uniformity of assessment already is demonstrated as feasible and there is opportunity for competent local professional support, not only through pride in State progress but because of mutual professional advantage. Even the most self-contained and efficient local assessing agency,

in little need of State technical aid, stands to benefit in protection and progress when its own professional standards are extended to the entire State under careful State supervision and coordination. It has less difficulty in justifying its budget requirements, a wider range for recruitment of staff, and better protection against competitive under-assessment and defective interarea equalization. Sound central supervision benefits the State as a whole.

#### *The Supervisory Agency and Its Functions*

The top priority responsibility of the State supervisory agency is to obtain reasonable uniformity in primary assessing throughout the State rather than to concentrate on patching up mistakes in the original job. The agency's most constructive means for this purpose are the provision of reliable professional information, aid and cooperation; but the agency also must have authority to issue orders and obtain compliance. The kind of organization, staffing, facilities, and powers that such an agency must have are identified best by the nature and scope of the functions that it is required to perform.

The central supervisory agency's four basic functions are central assessment, supervision, equalization, and research. For its function of assessing State assessed property, the agency needs skilled appraisal specialists for each class of such property, and also the means for drawing on the technical skills of other State agencies that can contribute to the quality and economy of assessment of particular classes of property. Concentration in a single agency of responsibility for the assessment and supervision of assessment of all components of the general property tax offers the most hopeful means of obtaining overall uniformity under integrated standards.



No central agency has a chance of meeting its responsibilities unless it has a well-qualified research unit, capable of producing a continuous flow of the facts needed for guiding supervision, and of carrying on valuation research to improve assessment methods and standards and find solutions for the assessment problems that endlessly emerge in the process of assessment throughout the State. Ratio studies, with their facility for generating information regarding the level and quality of assessment, have become an indispensable tool for both the supervisor and the local assessor, while a central agency providing valuation research meets a professional need that only the largest local assessment districts can provide well for themselves.

Central supervision, backed by adequate research, is the key to obtaining compliance with approved assessment standards by local assessors throughout the State and to achieving at least a minimum standard of assessment quality in every local assessment district. There is considerable futility and wasted expense, however, for a State to try to supply all the essentials of supervision to a host of small, inadequately staffed local districts. The full efficacy of the supervisory features advocated here is contingent on the existence of a setup for local assessment administration that meets the organizational and personnel standards recommended above.

The supervisory responsibilities of a well constituted central agency include, in addition to the factfinding study discussed below and the field inspection and conference that such study indicates as necessary, the provision of tools and equipment, provision of professional and technical services, training and orientation of assessors, and enforcement of standards.

There are certain basic tools and facilities without which a local assessor is unable to function efficiently. The central agency should have authority to provide those which it is best situated to supply, and to require local governments to provide the others. Among the fundamentals are the installation of accurate tax maps and suitable record systems. In carrying out its responsibility for promoting uniformity of assessment in accordance with well defined standards, the State agency is under the necessity of preparing, issuing, and revising periodically guides for local assessors in the form of handbooks of rules and regulations, appraisal manuals, special manuals and studies, cost and price schedules, and news and reference bulletins. To expedite the vastly detailed routines of preparing assessment rolls, tax rolls and tax bills, only the largest local districts can afford their own electronic data processing equipment; but it is feasible for many districts to enjoy the advantages of automation through the use of privately operated service centers or the installed facilities of the State government. Alert State agencies should be guiding this development.

The provision of adequate assessing tools needs to be reinforced by instruction and assistance in their use. A central agency that is able to provide adequate professional and technical services for this purpose can make a large contribution to the improvement of primary assessing. Such services range from answering inquiries to holding conferences, giving general assistance and advice, and helping with difficult assessment problems. To provide this aid competently, a statewide field service is needed, staffed by well trained appraisers with a broad knowledge of the assessment function who can check first-hand in each local dis-

strict any weaknesses disclosed by ratio studies and give the assessors on-the-spot assistance with their problems. If a State covers a considerable area, regional offices are called for. Additionally the central agency needs on its staff technicians and appraisal specialists who can supervise local mapping and reappraisal projects and appraise difficult types of property, under special agreement, for individual local districts when the amount of property involved does not justify the inclusion of such specialists on the local appraisal staffs.

While effectively functioning examples of the above and related forms of professional and technical aid may be found here and there among the States, a limitation that appears to be common to most of such programs is the inadequacy of their facilities. Either the authorized State supervisory staff is too small or the established salary schedule is too low to permit recruiting and retaining enough qualified technicians even to keep up with requests for local assistance. The consequences are particularly costly when deficiencies in State supervision fail to give some degree of permanence to the gains from the many expensive statewide revaluation programs which have been conducted in recent years.

*Recommendation No. 21. Each State should (1) evaluate the structure, powers, facilities, and competence of its present agency or agencies for the supervision of assessment administration; (2) in continuing the existing setup or in creating one more suitable, determine and establish clearly its proper and necessary functions, services and powers and equip it with adequate and appropriate personnel and facilities for meeting its responsibilities; and (3) provide for continuing systematic evaluation, by the legislative as well as the execu-*

*tive branch, of the usefulness of the agency and the means of improving its utility.*

Pre-entry and inservice training of assessors is an indispensable prerequisite for professionalizing the assessment function in which State supervisory agencies have, or should have, an important share. At the present time inservice training has two responsibilities. First, it tries to ground newly elected assessors in the rudiments of their duties, with endless and wasteful repetition because of the turnover in elected officers. Second, it seeks to perform the true function of inservice training by advancing the professional capabilities of assessors who, through appointment or repeated reelection, are career officers.

There is no satisfactory substitute for the continuous inservice training provided by competent, well-equipped State supervisory agencies through their provision of tools, personal instruction in their use, collaboration in solving difficult assessment problems, guidance in measuring and analyzing assessment performance, and otherwise broadening the local assessor's range of professional knowledge. Valuably supplementing such training, and sometimes attempting to compensate for its absence, are the extension courses, correspondence courses, and seminars conducted by several universities and the three- to six-day assessors' schools held annually in about half the States. These schools usually are joint undertakings of the State supervisory agency, a college or university, and the State association of assessing officers. The assessors themselves, through their State associations in a majority of the States and the International Association of Assessing Officers, have had an influential role in the advancement of professional training. Since education is a basic responsibility of all State supervisory

agencies, they should be empowered to sponsor and encourage worthwhile programs of these types.

When a State undertakes to establish professional qualifications for all assessors and appraisers, the very limited availability of well trained personnel is a major obstacle that has to be overcome. The past demand has not been sufficient to encourage much thorough, systematic pre-entry training for this profession and a few State supervisory agencies and tax study commissions have been considering how to meet this potential need. Desirably, the educational equipment for an appraiser should include, in addition to the broad background of a college education, a year's internship, with specialized instruction, supervised field assignments, and periodic examinations, which should carry maintenance pay and good assurance of a position upon successful completion of training. A State supervisory agency is best situated to plan and conduct such training.

*Recommendation No. 22. In any State establishing professional qualifications for assessors and appraisers, the State supervisory agency should cooperate with educational institutions in planning and conducting pre-entry courses of study, and should conduct or arrange for regular internship training programs.*

#### *Equalization*

Equalization, a technical term with imprecise connotations, figures prominently in the responsibilities of well-constituted State supervisory agencies. In a broad sense, it covers the entire process of producing state-wide uniformity of assessment; but in the type of State-local administrative relationship envisaged in this study, equalization, so far as individual local assessment districts

are concerned, is largely an integral part of the continuous process of State supervision and cooperation with local assessors to achieve intra-area uniformity of assessment. The term may be applied to such formal orders for adjustment as the State agency may find it necessary to issue to eliminate inequities within and among classes of property and among the various areas of a local district.

The State supervisory agency also has the functions of equalizing average levels of assessment among local assessment districts and between the State as an assessment district and local assessment districts. The former of these two functions, because of the urgency for such equalization as a basis for distributing State school aid, providing equitable distribution of the tax load in taxing districts served by more than one assessing district, and giving more reliability to the use of assessed valuations as a base for regulatory and measurement purposes, has tended in many States to receive much more attention from the supervisory agencies than the fundamental problem of obtaining intra-area equalization. The latter of the two functions also falls in the partially neglected category.

Recommendation No. 5, relating to the elimination of underassessment and effectuation of State fiscal regulation and measurement in terms of property values, supports the State use of assessment ratio studies for both intra-area and interarea equalization of assessments and, eliminating the need for assessing at full value or some specified percentage thereof and of the supervisory agency to enforce such requirements, proposes that State determined market value shall be the basis for regulatory and measurement purposes.

*Enforcement of Assessment Standards*

While ordinarily local governments constitute the local assessment districts and the assessing usually is done by local assessors whom they choose, the local responsibility is administration of the State assessment law under such supervision as the State provides. Under the form of careful State supervision here advocated, the supervisory agency's most desirable and constructive means of obtaining good quality assessment in accordance with the law are competent aid, advice, and cooperation; but the agency also needs the legal power to issue and enforce orders when suggestions and recommendations have gone unheeded.

Among the specific regulatory powers which the agency should have are the following: (1) to issue rules and regulations in accordance with the assessment law; (2) to require the observance of local office and personnel standards set by the legislature; (3) to require correction of clerical mistakes and errors in classification and exemption of property; (4) to order or institute the assessment of omitted property; (5) to order or institute reassessment of (a) individual parcels or items of property, (b) individual classes of property, (c) all property in an assessment district; (6) to order or institute equalization of average assessment levels among classes of property or among the various sections of a district.

Most of these items represent responsibilities now given to some State agencies; some represent responsibilities now conferred on local and county review boards. All need to be clearly the responsibility of the State agency in the first instance.

If persuasion fails to obtain compliance with its orders, the State supervisory agency must have adequate powers of enforcement against both the assessor and the assessment

district. In some instances the suitable recourse may be by court order compelling compliance; but the agency should have the power to remove from office, after a hearing, any assessor who wilfully disregards its orders.

Substandard assessment in a local assessment district may be less the fault of the assessor than of the local government constituting the district. Despite the recommendations and admonitions of the State agency, the local governing body may still fail to comply with the minimum standards for assessing tools, facilities and personnel, fail to make adequate appropriations, or otherwise seriously obstruct the work of the assessor. A few States try to meet noncompliance with supervisory agency orders uncompromisingly by such means as withholding part of the State school aid, but this hardly can be said to "make the punishment fit the crime."

Local weak spots of this character, in otherwise good statewide assessment performance, are likely to develop and become chronic unless a clear-cut and effective remedy is provided. Probably the surest remedy, for a State that is seriously intent on establishing and maintaining good assessment standards on a statewide basis, is for the legislature to set the low boundary of assessment performance that it will tolerate and require that any district whose assessing falls below this level for more than a specified period of grace shall have its assessment administration taken over and conducted by the State agency at the district's expense.

The efficacy of this plan depends on a specific mandate to the State agency from the legislature, including the spelling out of criteria to guide that agency's action. Legislative action necessarily would be

based on thorough study, analysis and testing, with the aid of the supervisory agency and other consultants, of the standard of assessing that is clearly feasible of attainment throughout the State. The take-over signal might be, for example, a combination of (1) failure to maintain adequate tax maps and records systems, (2) failure to meet minimum personnel requirements, and (3) assessments disclosing an index of inequality clearly in excess of a specified level of tolerance.

*Recommendation No. 23. To guard against weak spots among local assessing districts and to assure that assessing throughout the State meets at least acceptable minimum standards, each State should determine by thorough research the minimum level of acceptable assessment performance that can be tolerated, and require the State supervisory agency to provide for appropriate assessment administration, at district expense, in those local districts that fail to meet the minimum standard.\**

### FACTFINDING, ANALYSIS AND PUBLICITY

Without a continuous flow of carefully analyzed facts about the utilization of the tax and the quality of assessing throughout all taxing and assessing districts, neither the legislative nor the executive branch of a State government can determine with assurance what changes in tax policy and

\*Senator Muskie did not concur believing that the variety of factors causing poor assessment performance at the local level makes it undesirable for the State supervisory agency to rely exclusively on this severe corrective action. He felt that several techniques—some disciplinary and some stimulative—should be part of the State agency's arsenal of remedial powers. Flexibility and a practical awareness of the special problems of each individual case, in his view, should characterize the efforts of any such agency in its attempt to upgrade local property tax administration.

administration may be needed. One of the best weapons that a State has to strengthen the property tax, moreover, is a well informed public, thus the information gathered and analyzed for State use should be made available to the people in clearly understandable form.

*Recommendation No. 24. The State agency responsible for supervision of property tax administration should be empowered to require assessors and other local officers to report to it data on assessed valuations and other features of the property tax, for such periods and in such form and content as it prescribes, in adequate detail to serve its needs for supervision and study. The agency should be required to publish meaningful digests of such data annually or biennially.*

Through the development of scientific sampling and data processing, there has become available to the States an expeditious means of ascertaining the level and quality of assessing in all local assessment districts—the use of assessment ratio studies. The potential uses of such studies for State supervisory agencies, local assessors, and property taxpayers are numerous and valuable, in improving the quality of assessment, facilitating equalization, and helping the taxpayer protect himself against inequitable assessment.

*Recommendation No. 25. The State supervisory agency should be required to conduct, annually, comprehensive assessment ratio studies, in accordance with sound statistical procedures, of the average level of assessment and degree of uniformity of assessment overall and for each major class of property, in all assessment districts of the State. The agency should be required to publish the findings of each study, both as to the quality and average level of*

*assessment, in clear, readily understandable form.*

Each State, in its compilation and analysis of facts respecting the property tax, finds it exceedingly informative and useful to be able to make comparisons with similar data from other States. Obviating the need for each State to undertake, in order to satisfy its own requirements, the laborious process of gathering and adjusting to a comparable basis such data from other States, are the services of the U.S. Bureau of the Census. This agency, in addition to its valuable nationwide reporting of property tax data with a careful regard for interstate comparability, is contributing importantly through its assessment-sales ratio studies to comparative measurement of the varying levels and quality of assessing throughout the States.

*Recommendation No. 26. The States, for their mutual benefit in obtaining comparable interstate information on the property tax, should take all feasible steps to facilitate this function of the Census Bureau, particularly by improving and standardizing their own collection, compilation, and analysis of essential data.*

## REMEDIES FOR THE TAXPAYER

The taxpayer's first line of defense against inequitable assessment is the competent organization and procedure for good quality primary assessment that have been emphasized in previous sections, but he is entitled to effective remedies when he has a grievance. The State tax laws specify that assessments shall be uniform, at least within classes of property, and under the equal protection clause of the Fourteenth Amendment the taxpayer is entitled to fair treatment in the apportionment of the tax bur-

den; but in most States the review and appeal procedures give him inadequate protection.

In many States the hierarchy of administrative and judicial review and appeal agencies for the protection of the property taxpayers is elaborate; but actual protection under the various systems is illusory because, first, the tribunals to which the taxpayer must appeal are not well constituted and staffed for the purpose and second, the burden of proving his case is too onerous and costly. The small taxpayer, in particular, is helpless if he has no simple, inexpensive, and dependable recourse. While numerous States have been undertaking to improve assessment administration by such means as better State supervision, better training for assessors, statewide revaluations, experimentation with fractional assessment, and the use of assessment ratio studies for equalization purposes, they have tended to ignore the need to improve the procedure for assessment review and appeal.

A few States, however, have pioneered in devices specifically designed to provide the taxpayers with effective remedies and a few State courts have pointed the way to remedial action. While most of these developments have been too recent to permit evaluation of their efficacy in practice, they have been directed clearly to the removal of one or more of the basic weaknesses in the review process, namely: (a) most local review boards have less knowledge of assessing and less access to assessment information than the assessor himself; (b) many local review boards are given supervisory as well as quasi-judicial duties, placing on these usually part-time and ex officio agencies a professional responsibility for which they are not equipped and tending to create a diffusion of supervisory responsibility be-

tween local and State agencies; (c) the great majority of State review agencies are given an incompatible dual role, one of administration and supervision and the other of reviewing the performance for which they are responsible; (d) in judicial review, the courts are reluctant to interfere in administrative processes, the judges usually are not expert in assessing property, and the procedure is complicated, expensive, and impractical for the average taxpayer; and (e) when assessing is done at a level other than that prescribed by law or fails to follow any one discernible level, the assessing process becomes a mystery to the taxpayer and his task of proving discrimination becomes virtually impossible.

*Recommendation No. 27. The present administrative-judicial hierarchy of agencies for assessment review and appeal in most States should be objectively evaluated and reconstituted, as necessary, to provide the remedies to which the taxpayers are entitled, but do not now receive, under the uniformity provisions of State laws and the equal protection clause of the Fourteenth Amendment.*

*Recommendation No. 28. The review machinery should have a two-level organization, with both the local and State agen-*

*cies serving only an appellate function and being professionally well staffed for that purpose; the State agency—either an administrative board or a tax court—should be separate from any State agency for property tax administration, should be an appellate body to hear appeals from decisions of local review agencies and from central assessments by the State supervisory agency, and should include a small claims division with simple, inexpensive procedure; appeals from the State agency, but on questions of law only, should be to the supreme court of the State.*

*Recommendation No. 29. To aid the taxpayer in proving discrimination in his assessment, (1) the State supervisory agency should be required, following sound statistical procedures, to make and publish the findings of annual assessment ratio studies which, in addition to serving the purposes of supervision and equalization, will inform the taxpayer of the average level of assessment in his district; and (2) the legislature should provide that the assessment ratios thus established may be introduced by the taxpayer as evidence in appeals to the review agencies on the issue of whether his assessment is inequitable.*

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## **PART II**

**THE ROLE OF THE STATES IN DETERMINING TAX POLICY**



## Chapter 3

### THE NEED FOR A MANAGEABLE TAX STRUCTURE

A vast amount of discussion and effort are being expended to improve the administration of the property tax. All of this is encouraging but would be doubly so if more were being done to provide tax bases that are within the ability of the assessor to cope with and tax laws that can be administered. Many States have made progress along these lines, but others seem to have a lingering hallucination that virtually every class of property can be discovered and valued by the assessor and that poor tax laws can somehow produce good administration.

Thus improving administrative organization and procedure is only part of the job of strengthening the property tax. The law itself needs to be made more readily administrable. Obsolete constitutional provisions and archaic, fuzzy property tax laws need a complete overhauling to assure a tax that imposes no serious obstacle to forthright and equitable administration. The law also should not incorporate gross injustice in its provisions and should safeguard the rights of the taxpayer in fact as well as in theory; but as Prof. E. R. A. Seligman observed a half century ago:

On all sides we are realizing the fact that the question of efficiency is scarcely, if at all, subordinate to the question of justice. Or, let me put it rather in this way: that however well justified, and however thoroughly calculated to promote the ends of justice a given scheme may be, unless its administrative features are so arranged as to make it workable, the beneficent aims are bound to be frustrated; and a half-way good measure which is administratively unobjectionable frequently turns out

to be far superior to an ideal scheme which ultimately discloses serious faults in its administrative aspects.<sup>1</sup>

### THE PROPERTY TAX BASE

A basic question for which there is no unanimous answer is what classes of property should be taxed. Nearly a hundred years ago the virtually all-inclusive general property tax had come into general acceptance, with its rules of uniformity and universality incorporated into many State constitutions to assure their permanence. There was immediate and substantial erosion of this pretentious tax base; but it was mainly administrative rather than legal, by local assessors faced with a hopeless task. By the turn of the century the general property tax was under violent attack and taxes on intangible personalty and some classes of tangible personalty were being denounced as inequitable and unadministrable. How to salvage the property tax system became a serious concern of many tax specialists and civic and political leaders, and numerous remedial measures were proposed—and have continued to be proposed. From time to time the State legislatures and the voters have acted on one or another of the suggested reforms, in some instances with markedly beneficial results; but some currently urged property tax reforms are so reminiscent of the recommendations of a

<sup>1</sup> E. R. A. Seligman, *Essays in Taxation*, 8th edition, Macmillan, 1913, p. 332.

half-century ago as to mark the resistance to progress of this maligned tax institution with its cherished weaknesses.<sup>2</sup>

Since each State has had the responsibility for coping with its own property tax problems, the modifications and changes that have been made have followed no uniform national pattern and there are as many property tax systems today as there are States. The present scope of the general property tax ranges legally from broad coverage of real property and tangible and intangible personal property in a few States to exclusion of all classes except real property in a few others. Between these extremes the States have engaged in numerous gradations of erosion of the general property tax; some have classified property within the general property tax structure to permit taxation of the several classes at varying relations to value; others have withdrawn certain classes of property from the general base for special ad valorem taxation. No two States are in full agreement as to what the tax base should be, and the four States which have narrowed the base to real property—Delaware, Hawaii, New York, and Pennsylvania—differ as to what this class

includes.<sup>3</sup> This bewildering medley of taxes does have the unifying features of being "taxes conditioned on ownership of property and measured by its value" and of having some continuing problems that are more or less common to all the States.

#### *Personal Property Tax Problems*

The laws of well over one-half of the States still provide for taxing intangibles on an ad valorem basis but in only 11 of these is this elusive class of property subjected to the general property tax. The others impose special property taxes at low, fixed rates or classify such property for assessment at low percentages of full value. This policy avoids a tax that might take most of the income of some intangibles and mitigates the injustice which may arise from double taxation that occurs when representative property is involved; but it also has the hopeful purpose of inducing the property owner to make a full declaration of his bank accounts, stocks, notes, bonds, etc. The theory is that he will lie less if the penalty for honesty is reduced.

The ad valorem tax on tangible personal property in its broadest form is a very sanguine type of tax in what it anticipates both from the administrator and the taxpayer. Its heterogeneous coverage ranges from household goods and personal effects through movable machinery, equipment, and furnishings used in manufacturing and trade, manufacturing and commercial inventories, agricultural products, livestock and farm machinery, and equipment for transportation and communication. Not fastened down like real estate, much of this type of property has great mobility, raising complex questions of situs and allocation

<sup>2</sup> At its first annual conference, in 1907, the National Tax Association dealt harshly with the property tax, particularly the tax on personal property, and in 1910 it reflected the findings of a special study committee in a resolution "That the failure of the general property tax, in its application to personal property, is due to the inherent defects of its theory; that even reasonably fair and effective administration is unattainable; and that attempts to strengthen such administration simply accentuate the inequalities and unjust operation of the system." Forty-two years later, in 1952, another committee of the Association, appointed to study the personal property tax, was reporting that "The problem of how to tax property effectively or the alternative question of what to substitute for such taxation if it be abandoned is a perennial one in State and local government finance." (National Tax Association, "Interim Report of the Committee on Personal Property Taxation on the Taxation of Tangible Personal Property Used in Business," *Proceedings*, 1952, p. 76.)

<sup>3</sup> Pennsylvania has a county tax of 4 mills per dollar on intangibles and its tax laws still carry a little used tax on the value of occupations.

for taxation as well as the obvious problem of collection. The assessor, in his task of identifying the property owners, discovering and listing the property, and determining values, needs many skills and techniques other than those of the real estate appraiser, including some talent as a detective and a clairvoyant. Most States have narrowed the base for taxing tangible personalty at least in a limited way by excluding weak or popularly disliked elements of the base, providing partial exemptions of a few hundred dollars to eliminate small items, or developing a system of classification. Some States have restricted the base largely or entirely to property used in business. In a majority of the States, however, the existing systems are still less respected and less productive than they should be.

One of the conspicuous features of many personal property tax systems is the extent to which they have become legal fictions. In some States the difference between what is taxable and what is taxed appears to be strangely wide. The legal tax base is suffering extralegal erosion through administrative nonfeasance and what may be called, euphemistically, taxpayer noncooperation. Where, as in Illinois, the constitution still requires the taxation of intangibles at the full ad valorem rate, tacit or even judicial sanction for extralegal exemption or classification is quite understandable; but extralegal exemption extends also to various classes of tangible personalty in numerous States. The value of business inventories may shrink mightily for tax purposes, the assessor may be able to find only a fraction of the number and value of livestock discovered by the census enumerator, and ad valorem taxation of household goods and personal effects remains in the laws of some

States even when such property receives only nominal attention in tax administration.<sup>4</sup>

### *The Sham of Self-Assessment*

The traditional dependence on self-assessment is a main generator of the hiatus between taxable and taxed property. Some kinds of personalty are relatively easy for the assessor to discover and also not unduly difficult to value if he has available the necessary guides; but for many types of tangible and intangible personalty the assessor depends on the returns which all owners of taxable personalty commonly are required by law to make. The assessor may mail out detailed forms to a carefully compiled list of property owners, he may have such forms available on request, or he may rely on such returns as the property owners happen to submit. The property owner's declaration is likely to include only those items of which the assessor is presumably aware and to carry a valuation that is judiciously nominal. The assessor may accept it without much effort to check on its accuracy, possibly try to compensate modestly for its obvious shortcomings by using a higher assessment ratio than he applies to real property, and even feel some embarrassment at the receipt of an honest return. Negotiation and compromise tend to play a large part in the assess-

<sup>4</sup> Even where an effort is made to assess these classes of property the assessors may be urged to restrain their inquisitiveness. In Minnesota, "Although the statute authorizes assessors to enter any house or building and view it and the property therein, the Assessors' Manual suggests that cupboards, closets and drawers should not be opened by the assessor." (*Report of the Governor's Minnesota Tax Study Committee, 1956, p. 159.*) On the other hand, Phillip Cornick tells of the proposal in one city to apprehend and install as assessor a burglar who "had discovered more diamonds in one of that city's many wealthy homes than appeared in the summary of diamonds reported for taxation by all the city's diamond merchants and their patrons in a body." (P. H. Cornick, "The Tax on Tangible Personalty," in *Should Taxes on Tangible Personalty be Abolished?*, Tax Institute, Inc., 1950, p. 3.)

ment of business personalty. These procedures are not universal—numerous competent assessors use all of the means at their disposal to administer the personal property tax laws effectively—but they characterize the prevailing practice in widespread areas.

Under these conditions the personal property tax is a tax on integrity. The honest taxpayer is penalized and the ease with which the law is evaded has created for it a notorious disrespect. Something can be said, however, in extenuation of the dishonesty of the evader; he may feel pressure to match his business rivals in evasion or to protect himself against the illegal under-assessment that the assessor applies to other classes of property. Ronald Welch has commented that even a well-disposed property owner, when his instructions from the assessor lack precision and the local assessing policy is one of indeterminate under-assessment, "feels justified under these circumstances in signing a statement in which he places a low value upon his holdings."<sup>3</sup>

#### *Desirable and Necessary Goals*

Strong arguments have been advanced, time and again, for abolition of all ad valorem taxation of personal property and restriction of the property tax to real property. (Many of the advocates of this general policy would retain business machinery and equipment in the tax base.) Cited in support of this program are the unadministrable features of personal property taxation, the widespread condoning of evasion, the injustices inherent in some of the legal provisions, and the need to focus all resources on improving administration of the tax on real property.

<sup>3</sup> Ronald B. Welch, "Better Assessment Administration Increases Revenue," *Municipal Finance*, November 1954, p. 72.

Actually, the case for thus narrowing the tax base is not as strong as it might appear. Personal property, no less than real property, is part of the wealth of individuals; an owner of personal property is as much an owner of property as the owner of land and improvements. The property tax is a tax on things, not on net wealth or net income of persons, and when it discriminates among classes of property it favors some classes at the expense of others. Abolishing the tax on personal property either redistributes the property tax, concentrating a heavier burden on the owners and users of real property, or it curtails revenue badly needed by local governments. Replacement revenues are increasingly difficult to find, and in due course a State may regret having surrendered a potentially productive tax source in preference to placing it on a more administrable basis and supplying it with good administration.

A more practical course, in view of these interstate differences and disparities, and one that must be followed without delay if the property tax is not to become in another 20 years or so, as George Mitchell has predicted, "an all-but-forgotten relic of an earlier fiscal age,"<sup>4</sup> is for each State to take a hard, critical look at its property tax law and rid it of all features that are impossible to administer as written, whose honest administration would be economically intolerable, which force administrators to condone evasion, and which make taxpayer dishonesty a routine procedure. For those classes of personal property that have elusive mobility and take some effort to discover, there is need for ingenuity in replacing dead-

<sup>4</sup> G. W. Mitchell, "Is This Where We Came In?," in National Tax Association, *Proceedings of the Forty-Ninth Annual Conference*, 1956, p. 494.

letter provisions with taxing methods that work.

### *The Factor of Feasibility*

Feasibility of administration is one of the main tests of what constitutes an acceptable property tax base; but feasibility is a relative matter—heavily influenced by the quality of administration—and the range of unfeasibility tends to be exaggerated. Ad valorem taxes on most classes of property, real and personal, can be administered with reasonable competence and effectiveness if a State is willing to provide a suitable administration and back its operations with adequate appropriations and legal powers. The mythology of unfeasibility stems from trying to administer what has become a highly complex tax system by methods that were barely adequate for the simple types of taxable property in the early days of the Republic.

There has been sufficient accomplishment in a few States to support this assertion. In its special taxation of intangibles and classified taxation of business tangibles Ohio has a long and relatively successful record. In 1931, following abolition of the constitutional uniform rule for taxing personal property, a special joint tax committee of the legislature headed by Robert A. Taft proposed, and the legislature adopted, a property tax system that abandoned as a failure the taxation of household goods and personal belongings, concentrated on what it believed to be equitable and productive methods of taxing intangibles and business tangibles, and gave the State a dominant role in personal property assessment. Under efficiently centralized and reasonably well financed administration the State's rather complicated personal property tax system has proved manageable and receives a

good measure of taxpayer respect and compliance.<sup>7</sup>

In Maryland, which taxes most types of tangible personalty and some types of intangible personalty, the legislature has succeeded in developing a strange conglomeration of mandatory and locally optional partial exemptions and fractional assessment bases with interlocal variations; but it also has facilitated reasonably satisfactory assessment of the main types of taxable personalty by giving to a well organized State agency, the Department of Assessments and Taxation, extensive central assessment functions and strong supervisory authority over local assessment.<sup>8</sup> Oregon has minimized evasion of the tax on business inventories by requiring the State Tax Commission to audit annually 25 percent of all taxable inventory accounts in each county, and each account at least once in 5 years, with the expense borne equally by the State and the counties.<sup>9</sup> In both California and Wisconsin, where much local assessing is of superior quality and State technical assistance is highly competent, the assessment of personalty is well above the perfunctory level. In all of the instances cited, successful personal property assessment involves the use of specialists in this field and of all the available means to discover, list, and value the various types of taxable property.<sup>10</sup>

<sup>7</sup> This statement must be qualified in the instance of small taxpayers not covered by central assessment. For details respecting this system see vol. 2.

<sup>8</sup> Maryland's program in State-local integration of assessment administration is reviewed in vol. 2.

<sup>9</sup> This is only one of many developments in Oregon's broad program of property tax rehabilitation. See vol. 2 for details.

<sup>10</sup> The Ohio Department of Taxation, for example, examines over 200,000 Federal income tax returns annually as one of its means of auditing personal property tax returns, while Kentucky, Maryland, and Ohio require corporations doing business in their States to supply information on stock and bond ownership. The property tax on deposits in Ohio institutions is payable at the source.

Thus the factor of administrative feasibility does not necessarily limit materially the effective range of the property tax base. It need not deter a State that wishes to continue a broad tax coverage. Some States may wish for other reasons, however, to revise their property tax structures. A State may elect to exclude certain types of property because, in relation to the revenue potential, the cost of efficient administration is too high or the burden of compliance is too onerous for the taxpayer, as compared with some alternative form of taxation. A State may find, also, that efficient enforcement of some features of its property tax would have unjust or economically detrimental consequences, or that the amount of "snooping" required would be politically distasteful. Economic considerations are an increasingly important factor in decisions concerning exemption, classification and other modification, not only for conservation and development of a State's internal resources but for protection against interstate tax competition. Underlying all these and other considerations that may or should influence the future character of property tax systems, however, is the basic need, for the sake of public respect and the protection of honest taxpayers, for a State to abandon any component of the property tax for which it does not provide effective administration.

#### *Obstacles to Progress*

What with the usual vested interest in the status quo and the people who, like Ned McCaslin's horse, are "capable of only one idea at a time," any constructive revision of the property tax system is likely to be difficult and slow. The new property tax law adopted by the New Jersey Legislature in 1960, for example, was the culmination

of virtually continuous effort over a period of 20 years to remove obvious inequities in both the tax base and assessment standards.<sup>11</sup> The following are among the more perplexing obstacles and hazards that have troubled numerous States.

The uniformity clauses in State constitutions have been a major deterrent over the years to the efforts of legislatures to make property tax systems more flexible and more administrable through exemption and classification. As Professor Newhouse has concluded in his thorough and useful analysis, "First, there should be unanimous agreement that the so-called uniformity clauses and their supplementary provisions dealing with particular rules of uniformity have produced, more than anything else, confusion and litigation,"<sup>12</sup> This barrier to progress has been lowered gradually by the amending process, and in some instances by judicial interpretation, and a large majority of the State legislatures now have more or less authority to classify property for taxation; but in many instances the process has not gone far enough. Some States must rely on the courts for liberal interpretation of archaic or confusing constitutional provisions while some State constitutions are unclear as to basic policy and cluttered with details of statutory type. The evidence of experience is, according to many competent analysts of State government and this Commission, that detailed tax provisions have no place in State constitutions, and many will

<sup>11</sup> For an analysis of the controversial issues in this long-evolving program see James A. Arnold, Jr., *New Jersey Property Taxes and Tax Classification*, a report prepared for the Constitutional Convention Association, 1960.

<sup>12</sup> Wade J. Newhouse, Jr., *Constitutional Uniformity and Equality in State Taxation*, University of Michigan, 1959, p. 767.



agree that "Perhaps, indeed, the time has come to eliminate the separate uniformity provisions altogether and to rely instead upon the broad limitations of due process and equal protection to protect against arbitrary exercise of the tax power."<sup>13</sup>

Among the bizarre phenomena of the States' rich variety of property tax systems is the extent to which they are de facto rather than de jure systems. Many of them, as they actually are administered, bear a somewhat remote resemblance to the constitutional provisions and statutes. There are vast areas of extralegal exemption and classification, and, for example, in the days when "tax lightning" was terrorizing great corporations in New Jersey, it was merely the spasmodic effort of some local government to administer the tax law as written. This condition is conducive neither to high standards of administration nor to generation of respect for the property tax institution. The remedy is to produce a reasonable degree of identity between the law as written and the law as administered. When strict administration of some features of the existing law would be unfeasible or intolerable, the lines of necessary change in the law are clearly indicated. In making these changes, however, there are problems that must be recognized and solved as well as possible. If weak, poorly administered components of the tax are to be abandoned, how is an overall loss of property tax revenue to be avoided? If there is such a loss, how should it be replaced? How are such owners, in the event of ex-

emption or modification of taxes on personal property, to bear their fair share of the tax load and to be prevented from realizing windfall gains at the expense of real property owners? In the process of eliminating inequities, de facto as well as de jure, and thus reapportioning the tax load, to what extent and how should the harshness of the impact on the recipients of the higher tax burden be modified?

Exemption and classification are potentially useful legal devices for making property tax systems more readily administrable. Exemption can be applied to classes of property whose effective administration would be disproportionately expensive or beyond the capacity of an inadequate assessment organization. Classification, by removing inequities that generate evasion, can give the assessor more confidence in the justice of strict enforcement. These devices also have a potential for complicating administration, and sometimes for purposes for which there is no sound justification. In some States the long accretion of piecemeal exemptions, some representing merely capitulation by the legislatures to influential pressure groups, has complicated administration by baffling the assessor and adding needless minutiae to his job—as when a refrigerator is taxable in the basement but not in the kitchen, a pig that goes to market is tax free while a pig that stays home is taxable, or assessments are subject to various discounts for some kinds of ownership. In any carefully planned use of classification as a remedy for inequities and other ills it should be possible to foresee and avoid undesirable administrative side effects. If this device becomes merely the tool of preference seekers, the administrative conse-

<sup>13</sup> Paul W. Kauper, in his foreword to Newhouse, *op. cit.*, p. viii. Advisory Commission on Intergovernmental Relations, *State Constitutional and Statutory Restrictions on Local Taxing Powers*, October 1962.

quences, good or bad, are likely to be purely coincidental.<sup>14</sup>

When the tax on any class of property is eliminated or modified there is usually a problem of replacement involving the interests of both governments and taxpayers.<sup>15</sup> Offsetting revenue must be found and the effect of any resulting shift in the tax burden must be taken into consideration. (An exception to these requirements would occur if lowering the tax on, say, intangibles or business inventories made it more administrable and sufficiently more productive.) Among the ways of handling the replacement problem for local governments are: (1) shifting the load to the classes of property still taxed, which may be a solution of dubious equity; (2) authorizing compensating local nonproperty taxes, feasible for large units but impracticable for the many thousands of small units;<sup>16</sup> (3) authorizing

local supplements to some broad-based State tax; (4) levy of a new State administered tax for local allocation;<sup>17</sup> (5) increasing the amount of State aid; and (6) shifting one or more local government functions to the State (the last two usually involve increases in State taxes). Even if there is a financially successful solution of the replacement problem it may perform a disservice to local self-government by narrowing the range of its fiscal autonomy. The problem is further complicated by the frequently uneven impact on local governments of a tax exemption or classification measure. For example, the exemption of farm products in the hands of the producer would affect rural counties more than cities while the reverse would be true of the exemption of business inventories. It can be seen, therefore, that no substantial change in the property tax system can be safely undertaken solely on the basis of its own possible merits, but must be considered in relation to its effect on the State-local revenue structure as a whole.

## UPGRADING THE TAX LAW

Regardless of the nature of any State's property tax system, the efficiency and fairness with which the tax is administered depend very heavily on how the assessor performs his job. The assessor, even if he has great capability, has a poor chance of doing the job well if the tax law is a ramshackle accretion of legislative action over many years, its definitions of terms are unclear, its

<sup>14</sup> Ohio's carefully devised Classification Act of 1931 provided for the assessment of real property at 100 percent, manufacturing and agricultural tangible personalty at 50 percent and most other tangible personalty of business at 70 percent of true value. Probably unanticipated in the granting of a special dispensation to encourage manufacturing were the many administrative and legal problems generated by the numerous borderline-type businesses seeking a manufacturing classification. (See vol. 2 for a review of this situation and the built-in obstacles to its simplification.)

With respect to the Minnesota classification system, more comprehensive than that of any other State, a recent study committee said that "it is difficult to see how some of the classification and exemption provisions in the Minnesota law can be regarded as reforms. There seems to be no consistent rational pattern underlying the present classification ratios. They apparently resulted from the political balance of power or from special situations existing when they were established." (*Report of the Governor's Minnesota Tax Study Committee, op cit.*, p. 207.)

<sup>15</sup> New York had no replacement problem in abandoning its tax on personal property in 1933 because actual use of the tax had already faded into insignificance, and other States have had no complications in eliminating the vestigial remains of unenforced components of the property tax such as household goods.

<sup>16</sup> Advisory Commission on Intergovernmental Relations, *Local Nonproperty Taxes and the Coordinating Role of the State*, September 1961.

<sup>17</sup> Wisconsin adopted an approximation of this device on a large scale in 1961 by enacting a selective sales tax and increasing the personal income tax, with the bulk of the proceeds to be applied to reducing by 50 percent the personal property tax on farmers' livestock and merchants' and manufacturers' inventories, to reducing the property tax on public utilities, and to moderating high rates on other general property. See vol. 2 for details.

prescription of assessing standards, methods, and procedures is muddled or detrimentally restrictive, or if it fails to give the assessor powers that match his responsibilities. That property tax laws should accumulate archaic, conflicting, and unworkable provisions is a natural result of their long evolution, and the States have been recognizing increasingly the need for their reexamination and overhauling.

In its first report, in 1957, the Assessment Advisory Committee to the New York State Board of Equalization and Assessment declared:

Many of the laws relating to the real property tax are ambiguous or obscure. There has not been a comprehensive revision or recodification in 60 years. Patchwork amendments, which took care of specific problems without reference to related provisions, have created ambiguities and inconsistencies in the law which, in turn, have led to confusion in administrative rulings and judicial decisions.<sup>18</sup>

Since then all of the provisions of general application in the tax law, education law, village law and other laws relating to the assessment and taxation of real property (the only class of property taxed in New York) have been recodified and covering laws enacted by the legislature.

A project such as this, which goes beyond the routine codification of laws, is representative of what a number of States have undertaken over the past several years or are discovering the necessity for undertaking. In its preliminary report of 1961 the Texas Commission on State and Local Tax Policy commented that:

Most of the important parts of the property tax statutes were written well before 1900. Amendments have been added, often without specifically repealing the superseded article. As a result, even

the simplest question concerning the present property tax law often entails time-consuming search of case history, opinions of the Attorney General, or instructions of the State comptroller.<sup>19</sup>

Often troublesome to the assessor is the piecemeal accumulation of various and sundry exemptions, particularly when they have not been properly consolidated in a single article. Somewhat typical is the wry observation of one State tax commission that "The present laws relating to taxation of personal property abound in exemptions which have been inserted from time to time during a period of more than a century. Some of these exemptions are ridiculous, others are vague and indefinite of determination."<sup>20</sup> In Hawaii, where the long practice had been the individual granting of specific exemptions, the legislature, in 1961, followed the advice of its legislative reference bureau by providing general exemptions for desirable categories of institutional uses that would promote uniform treatment, discourage pressure, and improve exemption administration.

Even if the property tax law has been systematically recodified, annotated and made available to the assessor, with supporting regulations established by the State tax commission, it does not necessarily become a good law; but it has emerged from much of its haze for the assessor and its remaining deficiencies can be evaluated more readily. Some of the more commonly prevailing defects in property tax laws will be considered in subsequent chapters, but it may be noted here that nowhere is there more need for improvement in clarity than in specifying the basis on which property is to be appraised and assessed.

<sup>18</sup> Assessment Advisory Committee to the New York State Board of Equalization and Assessment, *A Look at Real Property Assessment*, 1957, p. 20.

<sup>19</sup> Texas Commission on State and Local Tax Policy, *Property Taxation and Local Revenues*, 1961, p. 2.

<sup>20</sup> Iowa State Tax Commission, *Annual Report—1952*, p. 16.

In the field of personal property taxation the local assessors in some States are not given the authority and State assistance they need to discover and appraise taxable property. In States that tax intangibles it should be possible, for example, for a tax on bank deposits to be collected at the source, as in Ohio, or for the assessor to require from the banking institutions lists of depositors and the amounts of their deposits, and also for the assessor to have the aid of the State tax department in discovering other types of intangibles.<sup>21</sup> In taxation of business personalty, the assessor is in no position to audit the returns of taxpayers unless he can examine their accounts and records. While there is clear recognition that State tax administrators must have these and other powers in their administration of income, sales and other taxes, including property taxes that may be within their jurisdiction, there is far less acknowledgment of the similar needs of local assessors.<sup>22</sup> One of three courses of action is called for: to give adequate authority to the local assessor, provide for assessment by the State, or abolish the tax.

### THE BASIS FOR PROGRESS

The development of administrable property tax laws is primarily the responsibility of State legislatures and State administrations. While progressive local governments have much to contribute from their experience in administering the tax, the State government makes the laws and also is in a

position to observe and study the requirements on a statewide basis and to determine the appropriate place of the property tax in the State's overall revenue system.

A familiar method for meeting this responsibility is for the legislature occasionally to set up a temporary tax study committee, either on its own initiative or at the behest of the governor. Often including prominent lay citizens as well as legislative members, the committee or commission employs consultants and in due course presents its findings in a report. This procedure has the virtues of producing an independent audit by specialists of the State's property tax system and focusing attention backed by the prestige of the committee's members and staff on the deficiencies and needs of the system. If the effort does not produce remedial legislation immediately there is still a chance of deferred action, and in any event the legislature always can create another temporary committee in some subsequent year.

Relying exclusively on temporary tax study committees for the development of workable property tax systems, however, is a reflection on the quality of a State government. A State is ignoring an obvious responsibility if both its legislature and its administration are unequipped for consistent study of this conspicuous, major, and difficult problem. There is increasingly widespread use by State legislatures of the kinds of machinery needed to cope with such problems—continuing joint special and interim study committees provided with research aid, well staffed legislative reference bureaus, and legislative councils, i.e., permanent research committees comprising leading legislators appointed by the two houses and equipped with research staffs and facilities to carry on continuous studies.

<sup>21</sup> In Kentucky, for example, most classes of intangibles are locally assessed, but the Kentucky Department of Revenue uses its effective resources to discover "omitted" or undeclared property. See vol. 2.

<sup>22</sup> The Washington Legislature recently acted forthrightly to authorize the local assessor, if certified by the State as competent, to examine the taxpayer's books.

The subsequent review, in volume 2, of recent State action to strengthen the property tax discloses significant contributions by such legislative research agencies in a number of States. What seems to be needed is the development of truly competent agencies of this type in more States, with this particular problem given a high priority on their agenda.

All but a few States have executive budget systems. This places the governor in a position of leadership (though more in some States than others) in determining fiscal policy and revenue sources for financing the budget. Always, even when it is not used for State purposes, the property tax looms unavoidably as an influencing factor in the determinations of the governor and his advisers. Its status has a great deal to do with the required amount and method of

distribution of local fiscal aid and also with the scope of the State's own operations. Thus the executive branch functions partly in the dark if its program of tax research (assuming that it has one) fails to include the property tax. The most productive property tax research by State administrative agencies—research that has been translated into more administrable and better administered property tax law—has been a carefully developed by-product of the work of well constituted agencies with important responsibilities in the actual administration of the property tax. They have reinforced, rather than duplicated, the research done by legislative agencies, and in some instances there has been effective collaboration. Consistent study and perseverance have paid off better than spasmodic and ostentatious efforts.

## Chapter 4

### THE CONFLICT OF ASSESSMENT LAW AND PRACTICE

The laws controlling the administration of the property tax must provide adequately for all phases of the administrative process, ranging from assessing through compiling the assessment roll, extending the tax roll (i.e., computing the tax bills for individual properties), billing, collecting, enforcing delinquent tax liens, and administrative review. Each step needs efficient legal procedure, effectively enforced; but none more urgently than assessment, the most difficult step, and one which concerns vitally the fair treatment of the taxpayer, the productivity of the tax, and many important features of intergovernmental fiscal relations. Yet in the administration of this step there is a widespread and disturbing conflict between law and practice.

State after State, over the past several years, has joined the movement to do something about the glaring discrepancies between the legal rules for assessment administration and its actual administration, until only a few have failed to reach at least the serious discussion stage. The many emerging programs vary considerably in their temerity, scope, method and perspicacity, offering prospectively a useful range of tests of the conditions of success or failure. If some of these programs appear to be based on an inadequate diagnosis of the ills to be remedied, it may be because a gradual approach was deemed the best strategy.<sup>1</sup>

<sup>1</sup> One shrewd political scientist could well have had the property tax in mind in his observation that "there is nothing more difficult to carry out, nor more doubtful of

Unequal assessment and underassessment are the main objects of attack, the former a violation of the principle that all taxpayers are to receive uniform treatment in the appraisal of their property and the latter a freewheeling digression from the legal mandate that all property is to be assessed at its market value, or, in a minority of States, at a specified percentage of such value. That this maladministration of the property tax infests a large part of the Nation is no news to taxpayers. It has been part of the property tax tradition, and for many years only a few State governments made more than half-hearted efforts to do anything about it; but in more recent years there has been a growing realization that in various indirect as well as direct ways the inept and illegal conduct of assessment administration has so distorted and stultified many of the fiscal policies and relations of State and local governments as to require some kind of control.

### THE PROBLEM OF UNEQUAL ASSESSMENT

The largest and most difficult problem, the solution of which would facilitate the solving of all other problems relating to as-

success, nor more dangerous to handle, than to initiate a new order of things. For the reformer has enemies in all those who profit from the old order, and only lukewarm defenders in all those who would profit from the new order, this lukewarmness arising partly . . . from the incredulity of mankind, who do not truly believe in anything new until they have had actual experience of it." (Niccolo Machiavelli, *The Prince*, ch. VI.)

assessment, is how to assure that all taxable property in an assessment district is appraised uniformly in relation to market value.

The assessor's task is to discover all taxable property in his district, collect and record systematically the pertinent information respecting its ownership, character, quantity and value, and analyze the information in order to determine the capital value of each individual property as of the assessment date. In attempting to specify the standard of value which the assessor is to apply, the laws use such varied terms as full value, true value, fair value, true cash value, and the like, and the courts have done as much to confuse as to clarify the issue; but the generally accepted concept of taxable value is market value, defined in such terms as: The price which a property would bring in an open market on a sale between a willing seller and a willing buyer, both conversant with the property and with prevailing general price levels.

Under such a definition, the assessor's determination of market value is relatively simple for those classes of personal property that have a reasonably standard and well-defined market, less simple for other kinds of personalty where there has been depreciation or obsolescence and no standard market price exists. With respect to real property, sales prices are a useful guide to the market value of other properties of similar classification, provided they are reasonably representative; but in the instance of some classes of real property sales are both infrequent and unrepresentative, and for still other classes of property there is virtually no market. Thus the assessor must use the rules of appraisal that are most appropriate in each instance, supplemented by his experienced judgment.

Even a cursory look at the assessor's function discloses something of its technical complexity. In the assessment of dwellings, a quite homogeneous component of real property, the assessor has to make a uniform determination of value for old and new houses, single-family and multifamily houses, and houses ranging widely in the materials and quality of construction, always with an awareness that values are influenced less tangibly by zoning, neighborhood trends, transportation facilities, accessibility to schools, and various other considerations. Actual sales usually are available to aid the assessor in his appraisal of dwellings, but he must rely mainly on other measures of value in assessing a heterogeneity of industrial and commercial establishments. In appraising land the assessor faces an almost frustrating diversity of character and use—urban land serving various functions, farm land ranging from grazing land to land suitable for intensive cultivation, forest land, mineral land, waste land, and land held speculatively for prospective higher use. The assessment of tangible personal property calls for still other tools and techniques. Railroad and other public utility appraisal involves, among other things, the appropriate selection of valuation formulas. If intangibles are taxed, the proper auditing of returns demands the development of special methods and facilities.

To meet the requirement of uniformity, the assessor, using the particular valuation methods that are most suitable for each class of property, must produce not only intraclass but interclass uniformity. This means, for example, that his appraisal of any given dwelling not only must have the same relation to market value as his appraisal of any other dwelling but must have the same relationship as that for any fac-

tory, grocery store, vacant lot or item of personal property. The only true basis for the assessor's appraisal is market value. Once that is determined correctly for all taxable property, the basic uniformity is not affected by the use of fractional assessment for tax purposes.

Because of the inherent difficulties in determining precisely the market value of some classes of property, because market values are not static, and because objective assessment procedures must be supplemented to some extent by the assessor's judgment, the attainment of absolute equality of assessment throughout an assessment district is not feasible. If the assessor can keep the variation in ratios within a fairly narrow range he is doing a very acceptable job. The taxpayers have great justification for complaint, however, if inequality exceeds a reasonable range because the assessor has failed to apply objective standards and to use all of the appropriate tools of appraisal.

A special hazard to uniformity of assessment exists when, as in most States, property is assessed partly by a central State agency and partly by local assessors. If, for example, the State agency adheres to the legal requirement of assessment at full value and the local assessors use various low fractions of full value, an obviously inequitable situation results. This type of inequality is a controversial issue in the State assessment of railroads and other public utilities.<sup>2</sup>

Several State supervisory agencies regularly accumulate enough statistical data to make quite dependable evaluations of the quality of local assessing (though not all of them use the data for this purpose); but not until the Bureau of the Census undertook a scientific sampling study, in conjunction

with the 1957 Census of Governments, of the relation of the assessed valuation of real property to sales prices of property sold has there been available on a nationwide basis any comparative statistical measurement of the degree of assessment uniformity. The primary purpose of the study was to estimate the full value of locally assessed real property in the United States; but for one class of property, nonfarm dwellings (which accounted for nearly one-half of the total valuation of locally assessed real property), the large number of measurable sales and the relatively homogeneous character of such property made it possible to develop data on the quality of assessment administration in each of 1,263 selected local assessing areas with all of the States represented. For each area the Census Bureau computed a "coefficient of dispersion" or index of assessment inequality.

Since this class of property seemingly lends itself well to uniformity of assessment, the test of assessing competence probably was less exacting than one which would have included all classes of property; but for this reason the findings were particularly disconcerting. A mildly exacting evaluation of the Census Bureau's findings discloses that the indicated quality of assessment administration ranged from superior to reasonably satisfactory in only one-fifth of the areas, while, at the other extreme, it was incredibly poor in one-sixth of the areas. The selected assessing areas included 395 with populations of 50,000 and more in 1950, and therefore clearly large enough to have competent professional assessment administration. An acceptable degree of uniformity was indicated for 22 percent of these areas, including a number with high-quality accomplishment; but the index in 20 percent of the areas disclosed almost in-

<sup>2</sup> This much controverted issue is discussed in ch. 13.



credible inequity. The differences among the States, as indicated by comparison of the median area indexes, were as conspicuous as for the individual areas. Wisconsin, Connecticut, and Maryland made a superior showing, a few others a good showing; but in 5 States there were no selected areas with acceptable performance and in 13 other States less than one-tenth of the areas could be so ranked.<sup>3</sup>

While the findings of the Census Bureau's study seemed to indicate that the quality of local assessing ranges from mediocre to almost unbelievably inferior over a wide portion of the Nation, they were encouraging in their indication that some results (at least for one important class of property) reach a very satisfactory degree of uniformity. The 86 major assessing areas, distributed over 27 States, that were shown to have from good to superior performance were well representative of the numerous types of communities included in the 395 major areas covered by the study. What is feasible for this representative group would seem to be within the reach of all.

### THE PROBLEM OF UNDER-ASSESSMENT

The laws of nearly two-thirds of the States appear to contemplate assessment at

<sup>3</sup> The indexes of inequality are reported, without conclusions as to their significance, in U.S. Bureau of the Census, *Taxable Property Values in the United States, (1957 Census of Governments, vol. V), 1959, Tables 16, 19, 22.* For a discussion of the foregoing evaluation see Frederick L. Bird, *The General Property Tax: Findings of the 1957 Census of Governments*, Public Administration Service, 1960, pp. 53-62. After this report went to press the Census Bureau issued its 1962 Census of Governments report on property values which indicates some improvement since 1956. For example, in 1961, of 493 selected areas with population of 50,000 and over, about one-third appeared to have a high degree of assessment uniformity. U.S. Bureau of the Census, *Taxable Property Values (1962 Census of Governments, vol. II), 1963.*

full value and the language of many of them is very specific on this point. In 12 States there are general provisions for assessment at specified percentages of full value: Alabama, 60 percent; Arkansas, 18-20 percent; Indiana, 33 $\frac{1}{3}$  percent; Iowa, 60 percent; Kansas, 30 percent; Nebraska, 35 percent; Nevada, 35 percent; Oklahoma, 35 percent; Oregon, 25 percent; South Dakota, 60 percent; Utah, 40 percent, Washington, 50 percent. In Hawaii the law contemplates the use of 70 percent but authorizes the State director of taxation, who is responsible for the assessment of all property, to use another ratio if he so indicates. The laws of four States, Maryland, Minnesota, Montana, and Ohio, have somewhat more complex provisions involving the use of fractional assessment,<sup>4</sup> and Connecticut, New Jersey (in a 1960 law not yet in effect), North Carolina, Pennsylvania, and Vermont provide some form of local option.

The assessment practice in most of the States bears little resemblance to the legal requirements. The actual level of assessment is below the full-value or fractional-value level prescribed by constitution or statute. The notable exceptions are a few States, such as Arkansas and Oregon, in which the law has been adjusted recently to approximate the existing local practice and the State supervisory agencies have been pressing for conformity. Deep underassessment on virtually a nationwide basis was disclosed by the Census Bureau's assessment-sales ratio study for the 1957 Census of Governments. It found that the assessed value

<sup>4</sup> Maryland, full value except fractional assessment of stock in trade for county tax purposes; Minnesota and Montana, various specified percentages of full value for different classes of property; Ohio, full value except 50 percent for manufacturing and agricultural tangible personalty and 70 percent for other business tangible personalty.

of locally assessed real property in the United States approximated only 30 percent of market value, with the levels for the individual States ranging from 7 percent in South Carolina to 66 percent in Rhode Island.<sup>9</sup> Only the most fragmentary data are available on the treatment of personal property.

A conspicuous feature of underassessment is its variegated pattern within individual States. While the laws of nearly all of the States contemplate uniform levels of local assessment, interarea differences in assessment level appear in all States and have a notably wide range in some States. Again, the Census Bureau's analysis of 1,263 assessment areas provides a means of interstate comparison. The interarea coefficients of dispersion developed in this analysis indicated 14 States to have a relatively high degree of interarea uniformity, with the others following a descending scale to a group of 8 States with extraordinary diversity—typically with individual area ratios ranging from under 15 percent to over 50 percent.<sup>6</sup>

Underassessment and interarea variations in assessment have long traditions, but since World War II the pernicious effects of these illegal assessment practices have intensified with the deepening of underassessment, formation of large school and other districts that may include not only several assessing areas but fractions of such areas, and the growing dependence on assessed valuations for other than tax base purposes. The States, having permitted their local governments and themselves to become bogged in a morass of trouble over these matters, face a problem of extricating themselves by

means that recognize fully the consequences of years of negligence. These consequences, some of which already have been overcome successfully by some States, include particularly the inequities of competitive underassessment, the misuse of assessed valuation for ancillary purposes, and denial of self-protection to the taxpayer.

#### *Competitive Underassessment*

Assessment within each of a State's local assessing areas can show a high degree of uniformity and still cause inequities for the taxpayers and distortion of State-local fiscal policies unless all of the local areas in the State use approximately the same level of assessment or the State applies some effective method for ironing out the differences. A cherished goal of many a local assessing district has long been to pay less than its fair share of State taxes, or of the taxes of a county or special district that depends on it for assessing part of its area, by outcompeting for low-level assessment the other assessing districts involved. In recent years another fruitful product of competitive underassessment developed when the States initiated compensatory school aid programs which granted the highest subsidies to those local districts whose assessed valuations seemed to indicate the lowest fiscal ability. Regardless of whether interarea variations in assessment levels are deliberate or accidental, they produce the same inequitable consequences. Efforts to equalize interarea assessment levels have been going on for over a century, but some State legislatures still seem to be oblivious to some phases of the problem.

#### *Elastic Measuring Sticks*

In addition to serving as bases for the application of tax rates, assessed valuations

<sup>9</sup> *Taxable Property Values in the United States, op. cit.*, table 12.

<sup>6</sup> *Ibid.*, table 18; see also Bird, *op. cit.*, pp. 63-65.

are used widely as measurement standards by State legislatures and in State constitutions. The diversity of this collateral use is enormous, ranging from a familiar imposition of ceilings on the taxing and borrowing powers of local governments to such less familiar applications as the determination of salary levels of some local officials and apportionment of State senatorial districts. In New York, for example, at least 30 statutes prescribe their use for five types of purposes and in Wisconsin they serve more than 80 statutory uses.<sup>7</sup> In some States, including both New York and Wisconsin, State equalized assessed valuations are used.

It would be hard to conceive, on the basis of its use in most but not all States, of a more unreliable measurement standard. In fact, it is the only widely used standard with a two-way stretch and a two-way shrink. As a manifestation of legislative fiscal policy it is rather meaningless, unless it represents an intent to provide assessors with blank checks to fill out as they see fit. A few typical applications will illustrate its absurdity unless its aberrations are neutralized.

Most constitutional and statutory limitations on the power of local governments to tax and borrow are related to the value of taxable property; but when they designate assessed valuation as the measure of that value they choose a measurement base that usually has been illegally arrived at, bears a nebulous and often remote relationship to any sound concept of actual value, may vary among the local governments so that the limitation has different connotations in different communities, and cannot be depended on to maintain in the future any

<sup>7</sup> Wisconsin Department of Taxation, *Statutory Uses of the State's Full Value of Taxable General Property Through Chapter 519, Laws of 1961* (mimeographed memorandum).

consistent relationship to actual value. Under the present dispensation in the great majority of States, regulatory policy is determined by the assessor rather than by constitution or statute. When the level of assessment declines from, say, 50 to 25 percent (a not untypical trend over the past several years) while the tax and debt limit ratios remain unchanged, the assessor has reduced effective taxing and borrowing power by one-half. Additionally, in his role as a maker of fiscal policy, he may have forced radical changes in local revenue systems, large increases in State aid, and circumvention of the tightened restrictions through creation of redundant special districts and authorities and resort to unduly costly methods of borrowing.<sup>8</sup>

Another example of the propensities of this measurement standard for twisting and distorting legislative policy is the flexible value of partial tax exemption for homesteads, veterans and other purposes. When the exemption is a specified dollar amount of assessed valuation, as is quite customary, the value of the exemption varies with the level of the assessed valuation. With any deepening of underassessment the exemption acquires more value. Thus veterans in a good many States get a much larger continuous bonus than the tax exemption laws appear to indicate and a homestead owner may acquire more tax shelter than the law originally contemplated.

Consideration of the prevailing assessment practice, as opposed to the legal standard of assessment, undoubtedly has influenced the formulation of these controls in some State constitutions and statutes; but since the adopted formulas were geared to

<sup>8</sup> For illustrations of these consequences see Bird, *op cit.*, pp. 40-44.

an already confused measurement base and were vulnerable to future changes in local assessing policy, the authors have been guilty of a casual lack of precision in their regulatory efforts. The States are finding it difficult and expensive to undo their mistakes, but a few are making notable progress.

#### *The Unprotected Taxpayer*

Under the equal protection and due process provisions of the Federal and State constitutions the property taxpayer is entitled to fair treatment in the apportionment of the tax burden and to a reasonable opportunity to be heard if he believes that his property is inequitably assessed; but protection under this right, particularly for the small taxpayer, tends to become more theoretical than actual because the taxpayer's burden of proving inequality is likely to be an undertaking of considerable effort and expense.

The existence of underassessment diminishes the taxpayer's chances of protecting himself. In the first place, it increases his

difficulty in determining whether he is being equitably treated. To find that his property is assessed at less than the legal basis of full value or designated fraction of full value offers no assurance. While his property, for example, is assessed at 50 percent of the legal base, it may be that the prevailing level of assessment for other property is only 25 percent of the legal base. The assessor is not likely to make a voluntary disclosure of this state of affairs and, in fact, may not know with any degree of precision what the actual situation is. In the second place, the taxpayer must obtain data that not only satisfy him as to the inequity of his assessment but may be introduced as evidence in his appeal for adjustment. Such evidence usually has been hard to come by; but the assessment ratio studies that are being conducted by an increasing number of States are dispelling for the taxpayers some of the obscurity that has surrounded assessment levels and also appear to have potentialities for facilitating taxpayer efforts to obtain equitable treatment.

## Chapter 5

### IDENTIFYING STATE RESPONSIBILITIES

Strengthening the property tax, in the light of its weaknesses as reviewed in chapters 3 and 4, calls for an administrable tax system and the elimination of inequitable assessing, underassessment, and wobbling measurement standards. Since in most States the tax is administered jointly by the State and local governments, the allocation of responsibility for producing these improvements is an important consideration. Irrespective of the existing setup, and irrespective of the feelings of some local governments that they have a vested interest in mismanagement of the tax, no State can afford to ignore its underlying responsibility for good property tax laws and their enforcement.

This study concerns itself with six State responsibilities, which may be identified as follows:

1. To know precisely and continuously what the property tax situation is throughout all taxing and assessing districts of the State, with respect both to the utilization of the tax and the quality of assessing, and to make well-analyzed and clearly informative data on these features regularly available to the public.

2. To amend or change property tax laws that are inequitable, unworkable, unduly restrictive, or otherwise unsatisfactory. This applies equally to laws which determine the tax base, establish limitations and exemptions, and set forth the procedures for administering the tax.

3. To determine the appropriate role of

the property tax in a well-integrated State-local revenue system and to guard against any grossly unequal distribution of the property tax burden.

4. To recast any features of the administrative setup that prevent efficient, equitable administration. This responsibility relates to both organization and personnel.

5. To provide effective State supervision and coordination of property tax administration.

6. To provide the taxpayer with readily usable and effective means of protecting himself against inequitable assessment.

### FACTFINDING AS A BASIS FOR PROGRESS

No State government can initiate and promote a successful property tax rehabilitation program unless it has the facts about the situation it is attempting to deal with. It must know, by individual assessment areas throughout the State, just how good or how bad the assessment administration is, and why it is good or bad. No State should have to rely on hiring outside investigators to discover this essential information; each State needs a thoroughly competent and well equipped agency with a continuing responsibility for providing this service. All but a very few States have some kind of permanent State agency for some kind of supervision of property tax administration, but until recently few of them could supply much of the kind of information that is in-

dispensable for an accurate diagnosis of local assessing ills. Many of them have had no field staffs or research divisions, and quite often any more than perfunctory attention to the subject has depended on the appointment of a tax commissioner who happened to be interested in property taxes.

The contrast among the States in their organizations and staffs for supervision of property tax administration is truly prodigious. Wisconsin has maintained a field staff as well as a central organization for over 50 years; a few other States, notably California and Kentucky, have had good supervisory facilities for some length of time; and in recent years several States have developed or are working toward good facilities. The valuation division of the Oregon State Tax Commission, for example, has a staff of over 100 compared with 15 in 1950 and New York's substantial and competent organization was nonexistent before 1949.<sup>1</sup> Many States, however, still have little or no permanent provision for systematic property tax supervision and research.

The State-by-State emergence of organized research and supervisory facilities is a hopeful omen of progress in the quality of property tax administration. Even a relatively small-scale effort has value if it is founded soundly on a factfinding basis. In Tennessee, to illustrate, the 1955 legislature directed the legislative council to make a study of property assessment. A subcommittee made an investigation that disclosed, among other things, that the median salary of county assessors was only \$2,400, only 4 of 95 county assessors had tax maps, and only 6 had adequate record systems and other necessary equipment. For objective evidence of the quality of assessment, assess-

ment-sales ratio studies were made in representative assessing areas, disclosing a predominantly inequitable situation. While the legislature undertook no drastic reform it created a permanent State agency to continue research and give professional aid to local assessors.<sup>2</sup>

## ASSESSMENT RATIO STUDIES

In these days of scientific sampling and electronic data processing, there has become available to the States an expeditious means of ascertaining the level and quality of assessing in all local assessing areas—the use of assessment ratio studies. The most commonly employed form—the assessment-sales ratio study—involves comparison, on a sampling basis, of the sales prices of sold properties with their assessed valuations, and application of statistical procedures to determine assessment levels and measure nonuniformity of assessment. Expert appraisals by a technician other than the assessor may be used to supplement sales prices for classes of property whose sales do not provide an adequate sample or they may be used as an alternative to sales ratio studies. Comparisons of assessed valuations with sales prices and appraisals have long been used by tax administrators and taxpayers, but development of the new techniques and facilities has permitted the use of ratio studies on a wide scale and with dependable results if the studies are properly planned and conducted.<sup>3</sup>

<sup>1</sup> For further details of Tennessee's program, see vol. 2.

<sup>2</sup> For explanation of the various procedures in assessment ratio studies and directions for their appropriate use, see National Association of Tax Administrators, *Guide for Assessment-Sales Ratio Studies*, Chicago, 1954. A detailed description of the methods and procedures used by the New York State Board of Equalization and Assessment in its conduct of assessment ratio studies, which combine sales and appraisals, is given in vol. 2.

<sup>3</sup> For descriptions of the organizations in these States, see vol. 2.

*The Prevailing Uses of Ratio Studies*

State agencies in over one-half of the States conduct regular statewide assessment ratio studies, either annually or biennially, and a number of other States have conducted occasional or special studies. A few State agencies have been relying on studies conducted by public utility corporations or other taxpayer interests. There is wide variety in the method and scope of the State studies. Some States depend entirely on sales data; a few, including California, Michigan, and West Virginia, rely on appraisals; and a considerable number supplement sales data with appraisals. Most of the State studies apparently are confined mainly or entirely to real property.

Thus far State assessment ratio studies have been directed mainly to restricted objectives. They have been employed chiefly to find the average level of assessment in each assessment area in order to facilitate interarea equalization—the process of adjusting for or offsetting the lack of uniformity among assessment areas in the level of assessment. Most commonly, in this role, they provide the basis for equitable distribution of taxes in taxing districts served by more than one assessment area and for the apportionment of school aid.<sup>4</sup> A few States, ignoring the multiple value of ratio studies, have been using them solely for school aid apportionment. Some, on the other hand, are employing ratio studies for such purposes as giving clearly defined and uniform value to tax and debt limits and improving the quality of local assessing, as will be noted later.

<sup>4</sup> For a useful summary of equalization programs, see Federation of Tax Administrators, *Equalization Programs and Other State Supervisory Activities in the Property Tax Field*, Chicago, 1957.

*Safeguards for Reliability*

The reliability and usefulness of assessment ratio studies depend on the money and skill that go into their production. A cheap, shoddy ratio study program is worse than no program, because it purports to accomplish what it is unable to do—provide reasonably accurate measurement data for assessments. Some State programs appear to approach this classification because they are too ambitious for the shoestring financing that supports them. The potentialities of this statistical tool for improving the quality of assessment and protecting the taxpayers are great, but they will not be realized without more financial support than has been forthcoming in many States.

Assessment-sales ratio studies have obvious limitations. In States with numerous small assessment districts there are likely to be many districts that fail to yield an adequate sales sample. Such studies are useful for classes of property for which representative sales are available, but not for classes of property for which there are few or no sales. The valid data derived from major classes of property that lend themselves to sales ratio studies comprise valuable information; but to impute these findings to all other classes of taxable property, real and personal, is somewhat less than scientific. Yet some statewide studies make this a practice because of lack of funds to do supplementary sample appraisals.

Some reconciliation of sound statistical procedures and budget limitations is needed. Ronald Welch, practicing authority on this subject in California, which spends about \$800,000 a year on its assessment ratio studies, has suggested the characteristics of "a compromise between the ideal program

and a cheap program." They may be summarized as follows:<sup>5</sup>

1. The program should be designed under the direction of a professionally competent statistician.

2. The assessments on each local roll should be classified into at least 10 or 12 categories, by use types and to some extent by assessed values. A separate market value estimate should be derived for each class of property by expanding the sample for the class.

3. Real property sales occurring for a period of time after assessed values have been fixed should be fully recorded in small jurisdictions and sampled in large jurisdictions. If the time interval between the fixing of assessed values by the assessor and the need for assessment-level findings is short, the market value for the preceding year can be found and carefully trended.

4. Parties to sales considered for use in the survey should be sent questionnaires concerning terms of sales, reliability of sales prices as evidence of market value, and exact nature of transferred properties; to be followed up by a second questionnaire or telephonic or personal interview. (It is more important to do a good research job on a small number of sales than a superficial job on a large number.)

5. In assessed-value categories that contribute materially to the total assessed value, but are represented by few or no acceptable sales, appraisals should be used either in lieu of, or to supplement, sales. The appraisal subjects should be randomly selected, and include personal property as well as real property.

<sup>5</sup> This is a summary only; the full text should be consulted. See Ronald B. Welch, "Measuring Local Assessment Levels Between Survey Years," in *Revenue Administration 1960*, National Association of Tax Administrators, Chicago, 1960, pp. 32-37.

6. The market values, whether derived from sales prices or from appraised values, should be matched with assessed values fixed prior to the sales dates and prior to the random selection of properties for appraisal. A ratio of assessed value to market value should be computed for each matched pair, and either the median ratio or the median market value and the median assessed value should be ascertained for each of the classes into which assessments have been grouped. From these medians an estimate of the total market value of the group should be derived. The sum of the market values for all groups may then be compared with the total assessed value to derive a measure of the jurisdiction's assessment level.

States that are making regular use of scientific assessment ratio studies recognize them as an indispensable factfinding tool, without which reliable equalization of assessments and effective supervision of assessing would not be feasible. For this reason the integrity of these studies must be safeguarded. This is a tool only for those agencies that are prepared to use it skillfully and judiciously.

#### THE GOAL OF ASSESSMENT UNIFORMITY

More and more States are discovering what a few have long known—that it makes more sense to work for good quality primary assessing than to concentrate on perfecting a hierarchy of review and appeal agencies to correct primary assessing mistakes. Such agencies are indispensable, and many of them need perfecting; but their share of the assessment process would be minimized if all primary assessing were done by competent assessors.



## THE CONTRIBUTION OF SUPERVISORY AGENCIES

The need for State administrative agencies well equipped for property tax supervision and research has been emphasized earlier in this chapter. The term supervision is used here broadly to cover not only regulatory and enforcement functions but the provision of technical aid to local assessment administrators. Such aid is a big factor in improving the quality of local assessing and some States are providing it reasonably well, but in many it is inadequate or perfunctory and in a few States it is virtually nonexistent. Some State legislatures, though faced with the problem of finding more money for local aid because of local mismanagement of the property tax, have failed to create, or provide adequate financial support for, such agencies.

Well-constituted supervisory agencies usually have the following functions: actual assessment of centrally assessed property (in a large majority of States, railroad and other public utility property, and in some States, certain other classes of property); conduct of interarea equalization programs; provision of supervision and professional aid for local assessing; compilation and publication of assessment and tax data; maintenance of a program of research. In some States such agencies also serve in a quasi-judicial capacity as tax appeal boards. These agencies and their functions are discussed in part III.

The research directed to improving the quality of assessing that is, or should be, carried on by these agencies necessarily follows two general lines. One deals with improving the techniques of assessing and developing valuation standards. The other calls for continuous and systematic evaluation of the quality of assessing within each local

assessment area. Without the latter the agency has no precise guide to how competent or incompetent the local assessing is and where the weak spots are, and it has no convincing evidence to present to the assessor. The potentialities of assessment ratio studies for this kind of research are great, but in many supervisory agencies they await adequate development.

### *Potential Uses of Ratio Studies*

As has been suggested earlier, the potential uses of assessment ratio studies for State supervisory agencies, assessors, and property taxpayers are numerous and valuable. They have utility, first, in indicating the general level of assessment in each assessing district within a State. That the benefits of this one item of factfinding are great is clear from mention of some of its obvious uses—disclosure of the degree of compliance with the legal basis of assessment; guidance for the individual taxpayer in determining the equity of his assessment; disclosure of full value of taxable property as one index of community fiscal ability; aid in the development of reliable measurement standards that use taxable valuations as a base; guidance for the equalization of State and local assessing; and indication of interarea nonuniformity in assessment to permit equitable distribution of taxes in taxing districts identified with more than one assessing area and equitable distribution of State aid. These studies have utility, in the second place, in disclosing for individual assessing areas the degree of nonuniformity of assessment among classes, and within classes, of taxable property.

Most of the users, in their preoccupation with solving the problems of interarea equalization, have not fully explored the opportunities provided by assessment ratio

studies to work toward the most fundamentally important goal of equalization—the elimination of inequities among classes and within classes of property in individual assessment areas. If the studies made for present limited purposes are conducted as reliably as they should be, with the use of all appropriate techniques for assembling, tabulating and analyzing the data, they can be made to disclose a wealth of illuminating information on the quality of assessing.

In New Jersey, for example, the careful conduct of an assessment ratio study program has played an important part in creating what the New Jersey Commission on State Tax Policy has called a new environment for local property taxation; and the New Jersey Supreme Court's ruling that state-determined average assessment ratios could be used as a basis for granting taxpayers relief from assessments at higher ratios has been, according to the State division of taxation, a long and important step "in the direction of making taxpayer appeal from uneven assessments easier than they have ever been before." In South Dakota, State Commissioner of Revenue Bruce D. Gillis says, "Inservice training has made the ratio study a practical tool which the assessor would not release."<sup>6</sup> The research division of the Kentucky Department of Revenue has developed a system of charting the quality of assessing in local assessment areas that is used, among other things, to evaluate progress resulting from State technical aid. The Wisconsin Department of Taxation has been developing special refinements in this product of assessment ratio studies.<sup>7</sup>

<sup>6</sup> See vol. 2 for an elaboration of these comments.

<sup>7</sup> Shown graphically by Werner W. Doering in *Refinements in Assessment Ratio Study Procedures*, a paper presented at the 30th annual meeting of the National Association of Tax Administrators, Philadelphia, June 12, 1962.

The multipurpose uses of assessment ratio studies are well illustrated by their employment in Oregon for equalization, improving the quality of assessment and helping the taxpayer to protect himself. The procedure, which is described in volume 2, has the following main features. Each county assessor is required by law to make an annual ratio study under regulations prescribed by the State Tax Commission which provide that results must be shown separately for several enumerated classes of property. The county board of equalization, which may retain expert assistance, is required to review the study and indicate in writing to the assessor any deficiencies in assessing that call for correction. The State Tax Commission, which makes its own ratio studies semiannually, also reviews the assessor's study. The ratio of assessed to full value as shown by the study, or as corrected by the board or Commission, by law must be posted by the assessor on the door of his office "in letters sufficiently large to be visible to a person with normal vision standing within 10 feet thereof." The law authorizes any taxpayer to use this ratio as the basis for appealing his assessment and directs county boards of equalization to be guided by it in passing on appeals.

## PUBLICITY AND EDUCATION

Getting universally competent property tax administration is going to require drastic changes in administrative structure, personnel and procedures, and is going to cost more, in most of the States. The taxpayers and the general public will not be prepared to support such changes unless they can be shown convincingly how bad assessing is in many areas and how good it can be under suitable conditions. The ruthlessly clari-

fyng statistical facts that State tax administrators have learned, and many more that they have yet to learn, from assessment ratio studies might provide the convincing evidence if they could be conveyed to the public in readily understandable form.

By far the most significant contribution that has been made to public enlightenment by this means is the Census Bureau's nationwide assessment-sales ratio study that was part of its property tax survey for the 1957 Census of Governments. This study directed public attention to the feasibility and useful potentialities of such studies, provided vital information for individual States and many localities that most of the States had not taken the trouble to develop for themselves, and permitted valid and useful interstate comparisons because the statistical procedures were on a nationally uniform basis. Regular repetition of such a study by the Census Bureau, even at the long 5-year intervals of its Census of Governments, can be extremely helpful to all States working for competent assessment, particularly if the Bureau gives more prominence to its findings and clarifies them for more ready comprehension by the public.

The States have been using assessment ratio studies primarily for administrative and regulatory purposes and for the most part have not done much to exploit their educational possibilities for the general public. One reason, perhaps, has been a reluctance to disclose painful facts that may stir troublesome local repercussions. In California, for instance, assessment ratio data were compiled but suppressed for a number of years before the legislature required their publication. On the other hand, as has been noted, Oregon regards these studies as a useful tool for the taxpayer as well as the assessor, and in more than one State even

the publication of carefully determined local assessment ratios has stimulated community action for reappraisals and improved assessing. States genuinely interested in strengthening the property tax might find it very rewarding to extract from their ratio studies more information on the quality of local assessing and courageously give it the publicity it deserves.

### SPECIAL REAPPRAISAL PROGRAMS

A considerable number of the States that in postwar years have become seriously interested in the improvement of assessment administration have undertaken to make a complete new start by requiring or sponsoring comprehensive reappraisal programs. In some States reappraisal is a more or less routine feature of administrative procedure. In Maryland, for example, it is a continuing cycle; in several States the law requires periodic reappraisals, such as every 4 years in Iowa and every 10 years in Connecticut; and in a number of States the State supervisory agency may order reappraisals where needed, even conduct them if the local areas fail to comply, or local governments may be authorized by law to undertake reappraisals voluntarily. Attention is focused here on the special programs, usually backed by specific legislation, in more than a dozen States in recent years.\*

\* With due allowance for a widely varying range in scope and State participation, the list would include at least Arkansas, Colorado, Georgia, Idaho, Indiana, Kentucky, Montana, Nevada, New Mexico, Oregon, Pennsylvania, Washington, and West Virginia. Note should be made of those States, such as Hawaii, Iowa, Maryland, Ohio, and Utah, where there have been comprehensive reappraisals in keeping with periodic requirements or established supervisory or administrative processes, and of those States, such as California, Florida, New Jersey, and Virginia, where there have been extensive voluntary local reappraisals with State encouragement and varying degrees of aid. Data on most of these programs are given in vol. 2.

These reappraisal programs have been adopted to correct assessment situations that have gotten so out of hand after years of neglect that nothing less than a complete reappraisal would serve to establish reasonable uniformity of assessment on a statewide basis. Some of these programs have been no more than temporary correctives, others have been designed to serve as the basis for permanently better assessment administration. Since a good reappraisal job is expensive, there is considerable financial waste if it fails to become a dividend-paying permanent investment.

In the light of experience, several conditions are necessary to realize maximum value from a comprehensive reappraisal program. (1) The project should be planned and closely supervised by a permanent State agency well equipped for the job. (2) The program should be conducted uniformly in relation to carefully predetermined standards and procedures. It is important that all property be appraised at its market value, regardless of the basis at which property is to be assessed for taxation. (3) The program should be designed broadly to include not merely the revaluation of property on the tax rolls but a search for omitted property, installation in local offices of tax maps, record systems, and other essential assessing equipment that are lacking or substandard, and on-the-job training in methods and procedures of State and local personnel assigned to the project. (4) There should be adequate provision to carry on a maintenance program following completion of the appraisal program. This means organization, staff, money, and authority to assure continuance of the newly established equity and orderly procedures. (5) The program should be as comprehensive as needed, with the State agency having full authority to

require reappraisal in any assessing area that refuses cooperation.

There are always the questions of who does the job and who pays for it. For a State agency to do the actual appraisal work, not merely supervise it, has certain advantages. It can assure uniform adherence to standards, learn first-hand the actual local conditions, and develop an experienced staff that will be well equipped to carry on the maintenance program. If, however, rapid completion of the job is called for, the best course is to rely on well qualified appraisal firms instead of trying to recruit a large temporary staff. Irrespective of whether the State agency or each local agency contracts for the work, the contracting firms should be from a State approved list, the State agency should control the contract specifications to assure adequacy and uniformity, and should be prepared to supervise the work, audit the results, and aid local officials in meeting taxpayer questions and appeals. The more competently equipped local assessment areas may be able to conduct the reappraisal themselves with the retention of additional personnel and aid from the State.<sup>9</sup>

For State sponsored reappraisal programs the State policy respecting cost sharing has varied widely. Apparently in all cases the State has met all or most of the cost of supervision, which in some instances has been valuable and in other instances not worth much. Most commonly the project cost is met by the local governments, but in Oregon the State has paid one-half of the cost, in West Virginia it is meeting 90 per-

<sup>9</sup> The technical aspects of preparing for such projects are well presented in International Association of Assessing Officers, *Revaluation Projects*, a report of the Committee on Revaluation Projects, Chicago, 1960.

cent of the cost, and in Kentucky the State bears the major share. Georgia is encouraging local reappraisal by making interest-free loans to local governments for this purpose. The advantages of cost sharing include the lowering of local resistance to the undertakings and the increased opportunity for the State to safeguard the standard of performance.

The lasting advantages of these special reappraisal programs depend largely in each instance on how well the State is equipped, or improves its equipment during the course of the project, to supervise the undertaking, gain insight as to what its general supervisory role should be, and carry on a successful maintenance program following completion of the appraisal program.

Too frequently there has been little consideration of such matters. New Mexico completed a statewide reappraisal in the late 1940's but the county assessors were not required to accept the results and none of them did. In 1951 the Pennsylvania Legislature required fourth to eighth class counties (59 of 67 counties) to conduct reappraisals, but other than its creation of a temporary committee to make preliminary preparations there was no State supervision. When Colorado's 1947 Legislature directed the State Tax Commission to undertake the reappraisal of all taxable property in the 1947-49 biennium and made a small appropriation for the purpose, the Commission ordered the reappraisal at 1941 levels of value, provided some technical assistance and encouraged the county assessors to hire additional help. When at the end of 5 years the work had not been completed in any county the project was terminated with various compromise adjustments. Some gains were made in equalizing values but the situ-

ation continued basically unsatisfactory.<sup>10</sup> In Kentucky, on the other hand, a systematic reappraisal program authorized by the legislature in 1949 is being carried on by the permanent staff of the Department of Revenue, gradually because of limited appropriations but efficiently and with some attention to maintenance arrangements. The Oregon and West Virginia programs typify widely different methods of coping with such undertakings on a large-scale basis.

The so-called reappraisal program initiated by Oregon in 1951 and approaching completion in 1962 turned out to be a sweeping rehabilitation program for the State's property tax system. The policy adopted was for the State Tax Commission to expand its facilities and conduct the reappraisals itself in cooperation with the county assessors and under contracts with the counties, the State paying one-half of the costs. As might be expected, the undertaking stirred some controversy as it progressed; but with courageous and competent administrative leadership, good legislative cooperation, and development of an effective educational program, Oregon has done fully as much as any State to place property tax administration on a sound basis. The tax laws have been improved, the assessment function is becoming professionalized, central appraisal has been extended to timber and large industrial properties, the State Tax Commission's strengthened property tax division is well qualified to carry on the maintenance program that is being developed, and, as previously noted, the taxpayers have been given a practicable means of defending themselves against inequitable assessment.<sup>11</sup>

<sup>10</sup> More recently Colorado has undertaken systematic professional supervision of local assessment; see vol. 2.

<sup>11</sup> For descriptions of these programs see vol. 2.

In 1958 the West Virginia Legislature reversed its long stand that property tax administration, although recognized as "antiquated, inefficient and inequitable," was a county responsibility, and directed the State Tax Commissioner to make or cause to be made an appraisal of all nonutility property in the State at its true and actual value. The cost of this program, estimated at \$10 million, is being borne 90 percent by the State and 10 percent by the counties. The work is being done under contract by outside appraisal firms. Although the office of State Tax Commissioner had only a very small staff available for supervision, it started the program without delay by employing several appraisal firms. It became evident before long that some of the contracting firms were not living up to the terms of their contracts and some had been paid for inferior work. This has been controlled by building a State staff adequate to supervise and audit the work. By early in 1962 the program was well advanced on a broad basis. No specific plans had been developed for a maintenance program, but contracts with appraisal firms provide for on-the-job training of specified numbers of State and county employees, and the State Tax Commissioner, in a 1961 report to the legislature, urged the prompt appropriation of funds for proper maintenance.

#### *The Problem of Built-in Inequities*

A disconcerting feature of assessment ratio studies and reappraisal programs is the amount of long-established inequity in assessment that may be brought to light. Some classes of property may have been paying much more, or much less, than their proportionate shares of the tax and a like distortion may be found within individual classes of property. When the indicated

adjustments are made, inevitably there is a corresponding redistribution of the tax load, along with divergent effects on capital values. If material nonuniformity is shown to exist among major classes of property, its correction may produce a sufficiently large shift in the tax burden to incommode the local economy.

Such conditions are bound to arise in many jurisdictions and have become conspicuous particularly where there has been a great divergence between the assessment levels for State assessed and locally assessed property. In Oregon, for example, it was found that railroad and other public utility property was being assessed at twice the level of locally assessed property. There the State Tax Commission was able to invoke an administrative solution by making a gradual approach to enforcement of the law that avoided the harshness of abrupt compliance. The assessment level for utility property was reduced by stages over a period of 10 years to bring it into conformity with the local level of assessment. There is no ready and uniform solution for this kind of perplexing problem in moving toward uniformity of assessment, but it no longer can be concealed and ignored.

#### *Full Value Versus Fractional Assessment*

Full value assessment, a legal requirement in the great majority of States, is invariably a legal fiction, and an increasing number of States are undertaking to wipe out this gross violation of the law through underassessment by setting some fraction of full value as the legal standard. The contention is that the level of assessment is of no consequence so long as all property in a taxing district is assessed uniformly at the same level. This position would be valid (except

for certain collateral inequities noted later) if all assessing were done competently; but in actual practice there is a tendency for nonuniformity to increase when property is assessed at low fractions of full value.

The Census Bureau's 1957 assessment-sales ratio study of nonfarm houses contained data that seemed to affirm this tendency. The following figures, placing all of the selected areas in the study in four groups according to their median assessment ratio and showing the median area index of inequality, indicate a progressive increase in inequality as the assessment level declines.<sup>12</sup>

<i>Median assessment ratio for nonfarm houses (percent)</i>	<i>Index of inequality median area</i>
Under 20.0.....	37.3
20.0 to 29.9.....	32.0
30.0 to 39.9.....	25.1
40.0 or more.....	22.2

It is easy for both the assessors and the taxpayers to be less alert to inequality when the assessment level is a low fraction of full value. A deviation from the norm in hundreds of dollars in a low-level assessment may attract less notice than a deviation in thousands of dollars in a high-level assessment, although the former may be more inequitable on a percentage basis. Since there is no point in increasing the hazards of the assessing process, a reasonably high floor is a worthwhile consideration in legalizing fractional assessment.

### LONG-RANGE REQUIREMENTS

No State can hope for much rehabilitation of the property tax through spasmodic efforts. Ridding this tax institution of all of its outworn but cherished rites and rituals will take persistence and time. Stressed in

this chapter is the need for a State administrative agency to use the best techniques for gathering and analyzing the facts about property tax administration and for applying the findings to assessment supervision and taxpayer education. Instead of comprising a few underpaid, undistinguished jobholders, such an agency must be staffed with competent, resourceful people who command respect and can get the ready cooperation of able local property tax administrators, and it must have adequate resources and authority.

Even the best of such agencies, however, can do little more than a routine job unless it has the understanding support of the governor and the cooperation of the legislature that created it. Long-term progress, in fact, will depend fully as much on the legislature as on the administration. Considering both the complexity and importance of the property tax, its investigation and study ought to be a continuing assignment for the legislative council and one of its subcommittees or for a joint interim committee. The development of beneficial liaison arrangements between the administrative and policy making groups will be no problem if both groups are aiming intelligently and sincerely for the same goal.

The concept of a skilled supervisory agency carrying on research, providing technical aid, applying sanctions judiciously as needed, and thereby producing a universally competent system of assessment administration is somewhat on the sanguine side. Such methods and procedures are a good way to begin the job and can be relied on to produce worthwhile results, but also they are bound to disclose basic obstacles to fully satisfactory progress. It will become obvious that there are laws which need changing, that there are assessing responsi-

<sup>12</sup> *Taxable Property Values in the United States, op cit.*, table 17.

bilities which need shifting, and that there are some features of the established assessment organization and personnel that fail to fit any plan of efficient, modern tax admin-

istration. A readiness to recognize and find sound correctives for such deficiencies underlies the long-range requirements for a strong property tax.



## Chapter 6

### ELIMINATING UNDERASSESSMENT

Full value assessment versus fractional assessment is not the issue under consideration here. About one-third of the States, as shown in chapter 4, legally authorize fractional assessment for all or part of their taxable property. Underassessment means assessment at a level clearly below that required by law.<sup>1</sup>

Policymaking is a legislative function. When assessors change the laws in their conduct of the assessment process or State regulatory agencies "equalize" assessments at a level which is remote from the constitutional or statutory requirement, there is administrative usurpation of legislative power. This administrative recasting of legislative policy, as has been shown, can and often does have widely detrimental effects. Some of it has been forced by the legislature's abdication of its responsibilities, but to give permanence to such conditions would do violence to constitutional principles.

#### FEASIBILITY OF FIXED-LEVEL ASSESSMENT

Technically, if the assessors are competent and adequately equipped and are allowed a reasonable range of tolerance, the maintenance of a specified level of assessment is feasible. Regardless of whether property is assessed for taxation at full value, at some uniform fraction of full value set by statute, or at some unauthorized fraction set by the assessor, the process must

<sup>1</sup> The reverse of this relationship, overassessment, was an issue in the depression of the 1930's but has had no widespread significance for many years.

start with an appraisal of the full value of the property, which is its market value. In all instances the task of the assessor, unless he is just guessing or copying the preceding roll year after year, is the same. He must find the market value of the property. It then can be assessed for taxation at that value or any fraction thereof.

The technical feasibility of this objective must be qualified, as noted, by allowance for a reasonable range of tolerance. Precision as to the level of assessment is no more attainable than precise uniformity of assessment. Market values must be approximated in many instances and, additionally, they undergo constant change of cyclical as well as secular character. Not all these changes, moreover, are uniform within a community; some occur variously in different sections as these sections improve or deteriorate. A complete reassessment each year may not be feasible or desirable; but if the checking of significant changes is a continuous process and adjustment for secular trend is made every few years, assessing can achieve what Tax Commissioner Thomas A. Byrne calls "a conservative full value rather than a precise reflection of the market level in any year."<sup>2</sup>

<sup>2</sup> Thomas A. Byrne, "Full Value Assessments in Practice: Reasons for Underassessment," in National Tax Association, *Proceedings of the Fifty-First Annual Conference on Taxation*, 1958, p. 426. Mr. Byrne, Tax Commissioner of Milwaukee and an outstanding assessment expert, after reviewing the reasons for underassessment, including the widely varying quality of assessment administration, concludes "that a full value assessment everywhere and on each assessment date is a result which is actually unattainable. The best we can hope for would be a periodic approximation."

*Need for Clear Legal Definition*

The assessor must have the guidance, in working for a reasonable approximation of the legal basis of assessment, of a clear, usable legal definition of full value—one that avoids forcing him to become an economic forecaster and restrains his "precautionary regard for inflation tendencies." The assessor should not have to contend with such equivocal statutory instructions as: (relating to real property) "The term full cash value . . . shall mean current value less an allowance for inflation, if in fact inflation exists," and (relating to certain personal property) "The term full cash value as used in this subsection shall mean current value without any allowance for inflation."<sup>1</sup>

Troubles caused by fuzzy definitions of value may be illustrated by what happened in Oregon. After launching its comprehensive reappraisal program in 1951, the State Tax Commission soon found that the statutory definition of true value, as construed by the courts, was a serious impediment to doing a sound job. According to statute, "True cash value of all property, real and personal, means the amount the property would sell for in the ordinary course of business, under normal conditions in accordance with rules and regulations promulgated by the State tax commission." The State Supreme Court ruled that under the "normal conditions" provision, determination of the true cash value of real property required adjustment of market value to a "constant value which levels the effects of depressions and booms." (Appeal of Kliks, 153 Or. 669.) This put the Tax Commission into the forecasting business, precluded a firm standard of assessment for

real property and, because the ruling had been extended only to some classes of personalty, prevented complete equalization between realty and personalty. In 1955 the legislature changed the definition to provide that true cash value shall be "market value as of the assessment date."

#### FEASIBILITY VERSUS PRACTICABILITY

Notwithstanding the technical feasibility of reasonable conformity with the law, nowhere on a statewide basis, so far as can be ascertained, does the level of assessed valuation approach a legal basis that has been long established.<sup>4</sup> For this discrepancy both the assessors and the State governments are responsible. Professionally well-qualified assessors have tended to concentrate their efforts on meeting the legal requirement of uniformity and to give much less attention to the level of assessment at which they achieve uniformity. Many assessors, however, have ignored the law for less professional reasons. Underassessment was less controversial, more pleasing to the taxpayers; or it enabled the assessor to serve as a self-constituted budget officer in lowering a community's taxing and borrowing power; or it had interarea competitive advantages; or it was a convenient way of obscuring mistakes. In postwar years the gap between law and practice has widened as, in Byrne's words, "the market has literally run away from assessors" while they kept their eyes glued too long to 1940 values.

<sup>4</sup>A comparison of the levels of assessment of locally assessed real property in the several States in 1961, as determined by the assessment-sales ratio study conducted by the Census Bureau, with the legal basis of assessment discloses that only in Oregon, which had just established a new requirement, was there a close approximation of actual and legal ratios. (See *Taxable Property Values*, 1962 Census of Governments, vol. II, table 13.)

<sup>1</sup>Tax Laws of Maryland, art. 81, sec. 14, subsec. (b).

A large share of the responsibility for this conspicuous breakdown in law enforcement belongs to the State governments. Quite obviously they have failed to enforce the law, but their culpability goes deeper than this because of their adoption of policies that have made the law virtually unenforceable. By their use of assessed valuation as a base for various regulatory purposes, they have placed a premium on underassessment.<sup>8</sup>

Property owners are convinced that an increase in their assessed valuations means an increase in their tax burdens, and beneficiaries of partial tax exemption know that such an increase means lower benefits. Thus public resistance to increases in assessment levels intimidates assessors and ties the hands of even the most scrupulous State tax administrators. Such increases stir popular resentment much more readily than inequities in local assessment rolls. According to a well-documented statement of an authority who has studied this issue intensively:

Undoubtedly the most impressive factor blocking compliance with the constitutional full value mandate is the paralyzing fear that any decision to raise depressed local assessment levels to full value would meet with overwhelming public opposition.<sup>9</sup>

In a number of States the State agency responsible for property tax regulation has the legal power to order local property tax administrators to raise assessments to the legal level, and in recent years some States have strengthened these agencies; but even the most competent have been baffled by

the wide gap between the assessment level and the legal base, the derangements that would be caused by disturbing the status quo, and the political unfeasibility of closing the gap and have resorted to compromise equalization policies that mitigate some of the ills of, but do not eliminate, underassessment.

#### ALTERNATIVES FOR REMEDIAL ACTION

The States have a choice among three possible courses of action to eliminate underassessment. (1) They can provide for effective enforcement of existing law. (2) They can change the law to conform more nearly to prevailing practice and then concentrate on effective enforcement. (3) They can abolish fixed assessment levels and abandon the use of assessed valuation for ancillary purposes.

Least likely to succeed is the first of the three alternatives when the legal and actual levels are far apart. Theoretically, it might be initiated in a very simple manner by the State tax commission's exercise of its authority to compel the adjustment of all assessments to the legal basis. Actually, this would be a good way to start a political revolution. Leadership that could induce the legislature to make all of the essential supporting legal adjustments and convince a rebellious public that the policy was desirable would be almost a miracle.

The second alternative has a better chance of acceptance. It requires less basic adjustments and is easier to sell to the taxpayers since the changed legal assessment level bears a closer resemblance to existing local levels. If the groundwork for this adjustment has been laid by State supervised reappraisals in all assessment areas where they were needed and by the develop-

<sup>8</sup>Also, as discussed in ch. 3, the property tax laws of some States are so inequitable that their strict enforcement would work injustice.

<sup>9</sup>F. John Shannon, *The Conflict Between Law and Administrative Practice in Valuation of Property for Taxation in Kentucky*, University of Kentucky, Bureau of Business Research, 1957, p. 61. Another important factor is the assessor's well-founded fear that an average assessment at 100 percent of full value would produce numerous assessments in excess of full value.

ment of competent and adequate State supervision of local assessing, the actual adoption of the plan is facilitated and simplified. In any event, adoption of such a program, unless it is virtually forced by court action, will depend on strong administrative leadership, cooperation by the legislature, active support by civic groups and local governments, and an effective program of education for the public. The effort is not worth undertaking, moreover, unless it includes adoption of satisfactory means to enforce the new law.

Varying versions of this plan have been adopted recently by a few States. Oregon, Arkansas, and New Jersey provide good examples. In Oregon, the way had been smoothed by a statewide reappraisal program in progress since 1951. Prior to 1953 all taxable property was required to be assessed at true cash value; then, because of general disregard of this standard, the legislature changed the law to permit each assessor, with the concurrence of the county board of equalization, to determine the ratio to be used. The requirements, noted in the preceding chapter, for verifying and publicizing the ratios seem to have worked fairly well; but in 1959 the legislature set a statutory level of 25 percent of true cash value to become effective in 1961 except for a few counties still undergoing reappraisal and for counties assessing at higher levels which they did not want to reduce. In 1957 the county ratios had ranged from 48 to 22 with a median of 30, but for the 1962 tax year the State verified ratios were at 25 percent for all but three counties—one electing to maintain its higher ratio and two still under reappraisal.<sup>7</sup>

<sup>7</sup> Oregon State Tax Commission, *Bulletin*, July, 1962, p. 8. Each county assessor, as previously noted, is required to determine his level of assessment annually by an

The broad program to rehabilitate property tax administration initiated by the legislature of the State of Arkansas in 1955 included the requirement that all property should be assessed at 20 percent of actual value, creation of an assessment coordination division, provision for regular ratio studies to check performance, and stimulation of local compliance by provision that if, by 1957, any county's assessed valuation level was below 90 percent of the established standard (i.e., below 18 percent) the county would lose a proportionate share of its State aid. While there was temporary postponement of sanctions, one county was penalized in 1960 and there was rapid improvement in the uniformity of assessment levels as disclosed by the ratio studies. Prior to initiation of the program the inter-area range in the level of assessment was from under 10 percent to over 20 percent. In 1961 the range was from 16 to 22 percent, with only four counties below 18 percent. Three of these were raised to the required level within the short period allowed for adjustment.<sup>8</sup>

In New Jersey the courts forced abolition of underassessment, thereby aiding the long efforts of the proponents of property tax reform. In 1957 the Supreme Court of New Jersey declared that the legal standard of assessment would be enforced by the courts at the suit of any taxpayer, and so long as the standard set by statute is 100 percent

assessment ratio study. The State Tax Commission, if it finds the ratio based on its own studies deviating more than 10 percent from that of the assessor, is required to substitute its ratio; if the assessor posts a ratio varying as much as 20 percent from determinations by the county board of equalization or State Tax Commission he is liable to prosecution and removal from office. In the view of some expert observers in Oregon, the county assessor is likely to produce more uniform assessing and more reliable ratio studies if he is not required to comply with a fixed level of assessment.

<sup>8</sup> For details of the program in Arkansas, see vol. 2.

of real value the courts would mandate that standard; but the court permitted postponement of compliance to give the legislature time to change the basis of assessment if it wished to do so.<sup>9</sup> In 1960 the State legislature provided, for taxes due in 1962 (later postponed to 1965), that each county board of taxation could set the level, in multiples of 10 but not less than 20 percent, at which all real property is to be assessed, with 50 percent to be the level if a county fails to set the ratio.<sup>10</sup>

### THE PREFERRED ALTERNATIVE

A third and, all things considered, the most satisfactory means of abolishing underassessment is (1) to purge assessed valuations of all uses except that of serving as a tax base, and (2) to eliminate all constitutional and statutory requirements for fixed levels of assessment; but only in conjunction with the requirement that a well qualified and equipped State administrative agency make a reliable determination annually of the average level of assessment and the market value of taxable property in each of the State's assessment districts. The market value, thus determined, would be used as a measurement base, doing away with the vagaries of fractional assessment for this purpose; the State determined average level of assessment for each district would show the taxpayer what the level of assessment for his property should be and give him a firm basis for appealing from an inequitable assessment; and data also would be available to control the distribution of equalizing State grants and to equalize tax rates of taxing districts served by more than one assessment district.

<sup>9</sup> *Switz v. Middletown Township*, 23 N.J. 580.

<sup>10</sup> See vol. 2 for other features of this property tax legislation.

### *Administrative Advantages*

Under this arrangement, just one basic legal requirement is imposed on the assessor—he must obtain reasonable intra-area uniformity in his assessing. He is freed from the legal responsibility of achieving uniformity at some fixed level specified by constitution or statute, and, because taxing and borrowing power are no longer controlled by assessed valuations, he is freed from pressure to hold down the assessment level. This plan, however, needs one qualification. Because assessing has a tendency to become progressively less uniform at low fractions of full value, it would be wise to set a minimum level. State enforcement of this minimum poses no difficult problems.

Broadening the reliance on the statistical measurement studies produced by State supervisory agencies would put pressure on these agencies to produce more reliable studies, which, in turn, should contribute to more scientific property tax administration. Also, State supervision of local assessment, freed largely from concern as to assessment levels, would be able to concentrate more on producing greater interclass and intraclass assessment uniformity.

### *Aid for the Taxpayer*

Fractional assessment, legal or illegal, is confusing to the taxpayer. He compares tax rates that lack comparability, and quite commonly has little readily available means of knowing, to say nothing of proving, whether his assessment is reasonably equitable. Full-value assessment would remove some of this confusion; but since it does not appear to be practicable, the State has a responsibility for removing as much mystery as possible from fractional assessment.

The means here advocated for eliminating underassessment would be unsatisfac-

tory without full, clear disclosure for the taxpayer. The State's statistical determinations as they affect each taxing district should have prompt and wide publicity, in readily understandable form and with clarifying explanation. Among the more obviously required data would be comparisons of market values and assessed values, not only for taxable property as a whole but by major classes of property. Removing the mystery from such factors would be painful in some jurisdictions, but in the long run it could remove a considerable amount of taxpayer injustice.

For the protection of the taxpayer, the State determined or verified ratio of assessed to market value should be made legally available to him as a basis for protesting and contesting an assessment which he believes to be inequitable. Oregon not only has made such statutory provision, as noted earlier, but has set up a small claims division of a new tax court to aid the small property taxpayer. In New York, a statutory amendment of 1961 permits the State determined "equalization rate" (which is on a full-value basis) to be introduced as evidence in judicial proceedings to review an assessment.<sup>11</sup>

#### *Full Value as a Measurement Base*

The irrationality of using assessed valuation as a measurement base has been emphasized in chapter 4. If a State government believes that local governments should be limited in the amount of their taxing and borrowing, its limiting action should be based on careful consideration of their fiscal capacities and the extent to which they may draw safely on these capacities. If taxable property values are to be used in

evaluating fiscal ability, then full value, rather than a tricky and elastic assessed-valuation yardstick or an equalized value that does not represent full value, is the true index of such ability. It measures the entirety of this entity, not just a variable fraction of it, and provides a clear concept of fiscal ability as the basis for studying and imposing rational limitations.<sup>12</sup> Likewise, if partial tax exemptions to homeowners, veterans or other beneficiaries of this type of legislative largess are to be based on dollar amounts of property value, they should be in dollars of full value, rather than of assessed value, so that the legislature can make a clear determination of the size of its munificence.<sup>13</sup>

All such regulation and dispensation should be placed on a full-value basis, regardless of whether, or how, underassessment is abolished. This change, when it can be effected by statutory means, would require the State legislatures to review all existing formulas involving assessed valuation and to recast them so that they have a rational relation to full value. One of the immediate advantages of the change, in fact, would be the pressure placed on legislatures to study and regenerate tax limit and debt limit formulas that no longer reflect legisla-

<sup>11</sup> This is not intended as an endorsement of the traditional method of limiting taxing and borrowing by local governments, but as a recommendation that, if it is used, the use should not be unintentionally muddled. For the views of this Commission, see Advisory Commission on Intergovernmental Relations, *State Constitutional and Statutory Restrictions on Local Government Debt*, September 1961, and *State Constitutional and Statutory Restrictions on Local Taxing Powers*, October 1962.

<sup>12</sup> As assessors would be subject to pressure to compensate for this provision by below-average assessment of partially exempt property, enforcement of the provision would require special State supervision. A more simple alternative might be a rebate in fixed dollar amount on the beneficiaries' tax bills, a device under consideration in New Jersey.

<sup>13</sup> See vol. 2.

tive intent and do a disservice to local government. When constitutional provisions are involved the obstacles to change are more formidable but still worth overcoming—including, if possible, the removal of such details from the constitution.

The use of full value as a measurement base is being demonstrated effectively in New York and Wisconsin, where local assessing continues at varying fractions of full value. Its use as a base for debt limitation was authorized by statute in 1961 in Pennsylvania, which provides extensive local option as to the level of assessment, but was declared unconstitutional. A plan in Illinois to use full value as a base for tax and debt limitation, however, has fallen short of its purpose.<sup>14</sup>

Local assessment levels in New York, legally required to be at full value, still range from under 30 to over 60 percent of full value; but these variations have no effect on the legal taxing and borrowing powers of local governments. In early postwar years, when the State constitution still restricted borrowing and taxing by local governments to specified percentages of their

assessed valuations, the effect of underassessment was an erratic and planless determination of such powers that threatened the ability of some local governments to function and brought outcries for more State aid. In 1949 and 1951 the constitution was amended to base the limitations of taxing and borrowing power on the full value of taxable property. (A 5-year moving average of full values, rather than that for a single year, is used as the base.) In the debt limit amendment small reductions were made in the controlling percentages to bring them into what was deemed good conformity with the full-value base. A special State agency was established to provide reliable full-value data by means of regular assessment ratio studies.<sup>15</sup>

One of the established functions of the property tax division of the Wisconsin Department of Taxation is the annual determination of the full value of taxable property in all taxing districts of the State. Operating through six district offices and with a trained field staff, the division is able to do an efficient job by supplementing its assessment ratio studies with continuous field appraisal work. These State full-value figures have increasingly numerous statutory uses—more than 80 according to a tabulation through 1961 by the department. In addition to exceptionally varied applications for which State equalized assessments are invaluable, they serve as the bases for most statutory tax limitation and constitutional and statutory debt limitation.

To recapitulate, one of the truly important prerequisites for strengthening the property tax is to disassociate assessed valu-

<sup>14</sup> Connecticut should be noted as having eliminated underassessment by permitting local assessors to set the levels of assessment, but without safeguarding this grant of authority by establishing a full-value measurement base for regulatory purposes. The legislature adopted this undesirable policy after a ruling by the Connecticut Supreme Court in 1957 (*Ingraham Co. v. City of Bristol*, 144 Conn. 374) that underassessment was completely invalid and contrary to the express provisions of the State statutes. The court said that when assessors followed such a policy "they indirectly assume a role which rightfully is not theirs to play." A tax study commission, reporting in 1959, proposed as a flexible compromise arrangement, replacement of the former statutory requirement of assessment at 100 percent of fair market value with an assessment level of 65 percent representing the upper range of existing practice with a zone of tolerance of 10 percent up or down within which there would be no basis for appeals against assessments. (Report . . . *Property Taxes in Connecticut*, 1959, pp. 66-70, 74-81.)

<sup>15</sup> See vol. 2 for the organization and operation of this agency, the State Board of Equalization and Assessment.

ation from all functions except service as a tax base. It is essential, for one thing, to get rid of primitive concepts of budget control that conjure with assessed valuations and tax rates, and place emphasis on budgeting and financial planning that make judicious use and apportionment of a community's basic fiscal ability, one good measure of which is the full value of taxable

property. It is essential, for another thing, to divest property tax administrators of their illegal power to dictate local ceilings for taxing and borrowing and confine them to their proper function of doing a competent job of tax administration.<sup>18</sup>

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<sup>18</sup> See Advisory Commission on Intergovernmental Relations, *State Constitutional and Statutory Restrictions on Local Taxing Powers*, October 1962.



## Chapter 7

### THE PLACE OF THE PROPERTY TAX IN THE STATE-LOCAL REVENUE SYSTEM

Of the \$18.0 billion of property tax revenues in 1961 nearly \$17.4 billion went to the local governments and only \$0.6 billion or 3.5 percent to the State governments; but this huge revenue item was of as much concern to State governments as if all of it were their own money. Each State and its localities share in one governing job and must draw from the same aggregate of resources to pay the costs. Since the State creates the local governments and determines their share of the governing role, it must see to it that their financial resources match their responsibilities. To the extent that sufficient revenue is not raised locally the State must provide it—or rely on the Federal Government to provide it.

The property taxes of local governments in 1961 represented 87.7 percent of local tax revenue, virtually the same proportion that prevailed through the 1950's. The bulk of the remainder was accounted for by the sales, gross receipts, and income taxes that some of the larger municipalities are using successfully as partial replacements for the property tax. These replacement sources, however, are identical with the major sources on which the States rely actually or potentially for the bulk of their tax revenue. To the extent that they are used locally they are not available to the State governments. While the local governments are using most of the property taxes, dipping into the major nonproperty tax sources that form the base of the State level tax structures, and drawing on various kinds of minor local tax and

nontax revenue, they are depending on the upper levels of government for a substantial portion of their general revenue needs—about 30 percent in 1961.

No lessening of the pressure for more State-local revenue is in prospect. State and local government responsibilities are bound to continue their growth as a rising and increasingly urban population requires more and higher-type services. The State governments face a dual demand that points to higher rates for their sales, gross receipts, and income taxes, or the need for adopting such taxes if they do not already have them—a demand for more State purpose revenue and a demand for more fiscal aid to local governments. Inevitably the property tax, a broadly productive tax that is exclusively in the realm of State-local government, will have to carry its share of the load.

#### INTERSTATE VARIATIONS IN USE OF THE PROPERTY TAX

On a nationwide basis the property tax, although it has declined in relative importance over the years, continues to be the largest single source in the State-local tax system. It accounted for 46.3 percent of all State-local tax revenue in 1961 and had not deviated much from this relationship for several years.<sup>1</sup> This national figure, how-

<sup>1</sup> The figure was at its low of 44.6 percent in 1956 and 1957, and was 46.2 percent in 1950, having declined from 49.4 percent in 1946, 56.7 percent in 1940 and a predepression 77.7 percent in 1927. (Data from U.S. Bureau of the Census.)

ever, conceals vast differences among the States in property tax policy. In the individual States property tax revenues in 1961 ranged from 13 to 70 percent of total tax

revenues, with the percentages for only 14 of the States concentrated in the 40-50 percent range. The distribution was as follows:<sup>2</sup>

Under 20 percent	20 to 29.9 percent	30 to 39.9 percent	40 to 49.9 percent	50 to 59.9 percent	60 and over
Hawaii... 12.7	Alabama... 20.8 Delaware... 22.7 South Carolina... 23.0 Louisiana... 23.0 Alaska... 24.4 New Mexico... 26.4 North Carolina... 28.3 Mississippi... 28.4 Arkansas... 28.7 West Virginia... 29.0	Georgia... 30.4 Kentucky... 31.1 Washington... 31.5 Oklahoma... 32.2 Tennessee... 32.7 Pennsylvania... 34.0 Nevada... 35.7 Virginia... 36.7	Florida... 40.6 Maryland... 42.2 Vermont... 44.6 New York... 44.7 Arizona... 45.4 Missouri... 46.1 Utah... 46.8 Rhode Island... 47.5 Idaho... 47.7 Oregon... 48.2 Texas... 48.7 Colorado... 48.9 California... 49.7 Michigan... 49.7	North Dakota... 50.8 Maine... 51.1 Ohio... 51.9 Wyoming... 52.6 Illinois... 54.2 Wisconsin... 55.0 Minnesota... 55.1 Indiana... 55.3 Connecticut... 56.4 Montana... 57.0 Iowa... 57.4 South Dakota... 57.7 Massachusetts... 59.1	Kansas... 60.4 New Hampshire... 62.8 New Jersey... 67.2 Nebraska... 70.5
Number of States... 1	10	8	14	13	4

The States have impelling reasons, as can be seen, for a new look at the property tax. Their views as to its proper role in their overall tax systems are sure to vary, but none of them can afford to disregard its potential value for the demanding years ahead. Those States that place substantial dependence on the property tax can increase its reliability by raising the quality of its administration. The few States that have not found it necessary to put much dependence on this tax can turn to it for a better-balanced revenue system. Those States that have permitted it to decline to a minor position through pressure or neglect, or have reduced its productivity through maladministration, or fear to put more reliance on it because its management is defective, have weakened their financial outlook. The States now undertaking remedial action are showing foresight, because constructive changes in the management and

use of the tax are not effected overnight and smooth adjustment can avoid harsh emergency measures at some later date.

#### THE PROPERTY TAX AND LOCAL SELF-GOVERNMENT

One factor that should be kept in view in determining the future position of the property tax is its close alignment with the outlook for local self-government. It is the only major tax adaptable to local use generally, regardless of the size and nature of the local jurisdiction. Aside from being a good revenue producer it has the dependability and adjustability that local governments need. The required revenue yield can be obtained from year to year with a convenient range of flexibility and a satisfactory degree of precision, and the collectability of most classes of property taxes is

<sup>2</sup> U.S. Bureau of the Census, *Governmental Finances in 1961*.

assured by an enforceable lien on the property. These virtues are vitiated in practice, however, if highly restrictive tax rate limits combine with deep underassessment to relegate the property tax to an inflexibly minor role in local government finance and inferior assessment administration stultifies the tax's reputation.

In at least a few States the spleen against the property tax has been so intense as to generate constantly increasing fiscal aid to local governments regardless of whether the local fiscal effort is adequate, or to deprive them of the opportunity to develop sound budgeting and capital financing policies. That inept and inequitable property assessment should be a barrier to reasonable dependence on the property tax, as it is in numerous communities, is a reflection on the State governments that have permitted such a condition to continue. Determination of the property tax base is strictly an administrative function demanding technical competence. The State itself could provide this service uniformly and efficiently on a statewide basis without encroaching on local prerogatives to determine fiscal policy and make financial plans.

An increasing recognition by tax study commissions and State legislatures that neglect and underuse of the property tax have been detrimental to both local and State governments is an encouraging development. The following are representative conclusions:

In Alabama, which has been depending on the property tax for only one-fifth of its State-local tax revenues, a tax study commission reported in 1957:<sup>4</sup>

In summary, many of the considerable pressures

<sup>4</sup> Report of the Committee on the Revision of State Tax Laws, *Current Tax Problems in Alabama*, Montgomery, 1957, pp. 13-14.

on the legislature to increase State appropriations are a direct result of the comparable low tax effort made by the local governments of Alabama. Conversely, the preemption of the most productive sources of revenue by the State, together with virtual neglect of the property tax, has left localities, particularly cities, with limited revenue resources. The trend has clearly been toward a highly centralized revenue system; the results, in part, have been low levels of services at the municipal level, and a heavy reliance on the several taxes administered at the State level . . . The comparative decline of the tax in Alabama may be attributed to constitutional rate limitations, numerous exemptions, and faulty assessment administration.

In South Carolina, where the property tax also is a relatively minor revenue factor, Prof. G. H. Aull, a tax economist who has made a number of notable studies of the property tax in the State, has characterized the State's property tax system as being "in a state of utter disgrace" and has declared:<sup>5</sup>

Because of the breakdown in this important source of local revenue the State has poured a substantial amount of other tax revenue into an attempt to shore up the structure of local government. In choosing this course (rather than forcing a modernizing of property tax laws), the State has neglected other important functions and weakened its own financial position without at the same time making any permanent contribution to the cause of local self government.

A tax study commission in Washington, reporting in 1958 on how to close the impending gap between expenditure needs and the yield of the existing revenue system, said, among other things:<sup>6</sup>

Fundamental to the concept of strong, effective local government is the proposition that the service responsibilities of local government should be balanced by fiscal capacity to maintain them at the

<sup>5</sup> G. H. Aull, No. 7 in a series of articles on "What's Behind South Carolina Financial Troubles," *Anderson Independent*, January, 1959.

<sup>6</sup> Report of the Tax Advisory Council of the State of Washington, *Financing State and Local Government in Washington*, Olympia, 1958, pp. 17-18.

level desired by the local taxpayers. This is of the essence of local self-government. Failure to insure this principle in Washington by a history of assessments below the level required by the State constitution and statutes has resulted in the need for increased State grants and shared revenues, and has contributed heavily to the shift of responsibilities from local government to the State . . . *A vigorous effort must be made to rehabilitate the property tax, to make it more equitable among property owners, and at the same time make it more responsive to the revenue needs of the various units of local government . . .*

In West Virginia, where the State government is supervising a statewide revaluation of taxable property, a tax study commission concluded in 1960 "that the property tax should be called upon to bear more of the increasing costs of local government and the public schools," and recommended "the furtherance of the statewide property revaluation program as rapidly as possible as a means of eliminating or reducing the inequities of property assessment and making more money available on the local level for public schools, county and municipal governments."<sup>6</sup>

#### MORE REVENUE THROUGH BETTER ASSESSMENT ADMINISTRATION

More dependence can be placed on the property tax when assessment administration meets high standards, i.e., when all taxable property is on the tax roll, all property is assessed uniformly in relation to market value, and the assessment level has not been allowed to deteriorate. In fact, the establishment of these conditions where they have not prevailed in the past may increase the productivity of the tax without increasing the burden of the taxpayers who have been paying their fair share of the total.

<sup>6</sup> Final report of State Tax Study Commission, *West Virginia Taxes*, Charleston, 1960, pp. 12-13.

In the great majority of States there probably is little taxable real property that is escaping assessment. Even in recent years, however, searching reappraisals in some States have discovered considerable areas of land and numerous improvements that were not on the assessment rolls, and have found many assessing offices that were not equipped with adequate maps and other guides that would prevent such omissions.

In many of the 46 States that tax some or all kinds of personal property there would appear to be large amounts of such property that have been eluding the assessor entirely or have been assessed very nominally.<sup>7</sup> Personal property has been losing ground relatively as a tax base; it represented only 15.9 percent of all locally assessed property in the United States in 1961, compared with 17.4 percent in 1956.<sup>8</sup> Undoubtedly there is a sizeable revenue potential in personal

<sup>7</sup> The personal property tax on motor vehicles is a good example of a potentially important source of revenue which is not as productive as it should be in some States. A simple remedy is to make the registration of the vehicle contingent on payment of the tax. In Texas, where difficulties in levying and enforcing this tax have made it unproductive except in a few taxing districts, a study commission has proposed amendment of the State constitution to permit special treatment of motor vehicle taxation and enactment of legislation providing that (1) the State Tax Board establish market values for all makes and models of registerable vehicles, (2) the tax rate be set uniformly at \$1.50 per \$100 of market value, (3) the tax be collected at the time a vehicle is registered, and (4) the proceeds be distributed by county treasurers in accordance with a prescribed formula. This tax, it is estimated, would yield about \$52 million a year for local government purposes, most of it representing new money. (Texas Commission on State and Local Tax Policy, *Summary Report No. 8*, Austin, August 1962.)

<sup>8</sup> U.S. Bureau of the Census, *Property Tax Assessments in the United States* (Preliminary Report No. 4, 1962 Census of Governments, August 1962) and *Taxable Property Values in the United States, (1957 Census of Governments, Vol. V)*, 1959, p. 3. This recent decline, in the opinion of some tax administrators, reflects an equalizing downward adjustment in the level of assessment of business personalty, which in earlier postwar years had been assessed at a higher level than realty in numerous jurisdictions.

property taxes that is awaiting development; but, as emphasized in chapter 3, the tax must be worthy of enforcement, the tax law must be made administrable, and the administrative provisions must be adequate.

The derogatory mythology that has been built around the property tax in many parts of the country is partly a product of maladministration. Raising the quality of administration of the tax to that of other major taxes may not make the taxpayer enjoy paying the tax, but he is much more likely to pay it without resentment if he has assurance that assessments are reasonably uniform, that all taxable property is sharing proportionately in the burden, and that the tax holds a carefully considered position in a well-balanced State-local revenue system. Establishment of competent professional tax administration, regular publicizing of reliable data on the level and quality of assessment, and facilitation of appeal of assessments by the taxpayer are the important keys to maintaining the productivity of the property tax in areas where it is in substantial use and to increased dependence on it in areas of subnormal use.

### STATE USE OF THE PROPERTY TAX

Thirty-seven States, according to the Census Bureau, still levy some kind of State property tax that produces at least \$1 million annually.<sup>9</sup> The aggregate of such taxes in 1962, however, was only \$640 million or 3.1 percent of total State tax revenue; in many of the States the amount levied is rela-

<sup>9</sup> Five states levy no State property tax—Alaska, Hawaii, Oklahoma, Rhode Island, and Tennessee; for eight other States the Census Bureau reported property tax revenue in 1962 ranging from \$2,000 to \$395,000—Arkansas, Connecticut, Delaware, Massachusetts, Oregon, South Dakota, Vermont, West Virginia. (U.S. Bureau of the Census, *Compendium of State Government Finances in 1962*, 1963, p. 11.)

tively negligible; and over one-half of the total amount comprises special property taxes rather than general property taxes.<sup>10</sup>

The general property tax, which supplied about half of all State tax revenue in 1902, has been abandoned largely or entirely for State use by State after State. In 1932 it still accounted for 22 percent of all State tax revenue, but by 1942 the proportion had dropped to 3.5 percent and in 1962 it was only 1.3 percent. Of the 27 States that still levy a State general property tax, only a few place much dependence on it. In 1962 it accounted for 28.6 percent of State tax revenue in Nebraska, 18.0 percent in Wyoming and 13.3 percent in Arizona. In five States it provided between 5 and 10 percent and in seven other States between 3 and 5 percent. The amounts and percentages for the 27 States in 1962 are shown in the table on the following page.

Prior to 1930 six States had given up the general property tax for State purposes, influenced largely by the theory that it was desirable to separate State and local revenue sources and the belief that this policy would discourage competitive underassessment.<sup>11</sup> The 1930's brought sweeping replacement of State general property taxes by new sources of State revenue and a dozen States withdrew entirely or almost entirely from the tax.<sup>12</sup> In some instances this policy was

<sup>10</sup> The special property taxes include such items as California's in lieu tax on motor vehicles (representing most of the State's special property taxes of \$136 million in 1962), a large part of which goes to local governments; Washington's motor vehicle and aircraft excise tax, also mostly for local governments; Wisconsin's State tax on public utilities; and State taxes on intangibles in Florida, Kentucky, Michigan, North Carolina, Ohio, Virginia, and several other States.

<sup>11</sup> California, Delaware, New York, North Carolina, Pennsylvania, and Virginia.

<sup>12</sup> Florida, Illinois, Michigan, New Hampshire, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Vermont, West Virginia. Numerous other States sharply reduced its use in this period.

## THE ROLE OF THE STATES IN STRENGTHENING THE PROPERTY TAX

*State General Property Taxes, 1962<sup>1</sup>: In Amounts and Percentages of Total State Tax Revenue*

State	Million dollars	Percent	State	Million dollars	Percent
Nebraska.....	\$27.1	28.6	Louisiana.....	\$16.0	3.3
Wyoming.....	7.9	18.0	Colorado.....	6.1	2.6
Arizona.....	24.8	13.3	Washington.....	11.7	2.2
Montana.....	6.9	9.6	Mississippi.....	4.2	2.1
Utah.....	10.2	8.8	Iowa.....	3.9	1.4
New Mexico.....	9.7	7.0	Missouri.....	5.4	1.4
Minnesota.....	23.7	5.9	Wisconsin.....	3.9	0.8
Alabama.....	14.9	5.0	Ohio.....	5.7	0.6
Idaho.....	3.2	4.5	Kentucky.....	1.6	0.5
Texas.....	40.6	4.3	South Carolina.....	1.2	0.5
Nevada.....	2.2	4.1	Georgia.....	1.4	0.3
North Dakota.....	2.5	3.9	Indiana.....	0.7	0.2
Maryland.....	14.8	3.7	West Virginia.....	0.3	0.1
Kansas.....	7.8	3.4			

<sup>1</sup> From U.S. Bureau of the Census, *Detail of State Tax Collections in 1962*, November 1962. (Data are preliminary.) In addition to these 27 States, Maine levies a tax on its unorganized areas and New York a court stenographers' tax, accounting in 1962 for 1.8 percent and 0.2 percent, respectively, of State tax revenues.

directed primarily to helping hard-pressed local governments; but depression conditions gave property tax relief great popular appeal and some States combined abandonment of the tax for State purposes with increased restrictions on its local use. In the late 1940's, when the States were still enjoying their war-generated affluence, five more States—Arkansas, Connecticut, Massachusetts, New Jersey, and Tennessee—withdraw from the tax. Texas adopted a constitutional amendment in 1948 (effective in 1951) prohibiting State use of the tax for general purposes, though continuing its use for confederate pensions and part of the State aid for schools. Maine withdrew from the tax (except in unorganized areas) in 1951, but authorized local governments to continue levying the State rate for local purposes. Neither of the two newest States levies a general property tax, Alaska having discontinued its use for territorial purposes in 1953 and Hawaii having dedicated it to local use in 1911.

State general property taxes are used mainly for the financing of State government but some of the proceeds are di-

rected to local purposes, mostly public schools. An analysis by McGehee H. Spears of the U.S. Department of Agriculture indicated that the total of such taxes in 1957 was distributed 31 percent for the State general funds, 24 percent for public schools, 18 percent for other education, 15 percent for debt service, and 12 percent for various earmarked purposes.<sup>13</sup> An indeterminate portion of the tax going to the general funds is directed to local aid; Missouri, for example, has been allocating one-third to counties for the support of schools. Public schools have been receiving all of the State tax in Utah, around four-fifths of it in Texas and Wyoming, and smaller portions in several other States. A dozen States use the State tax to pay principal and interest on some or most of their general purpose debt. Maryland uses its tax entirely for this purpose, and Iowa and Ohio, which previously had abandoned the tax, re-adopted it to service veterans' bonus bonds. Some States, among them Illinois, New Jer-

<sup>13</sup> U.S. Department of Agriculture, Agricultural Research Service, *The General Property Tax in State Finances*, April 1960, pp. 11-13.

sey, and Oregon, while they do not levy general property taxes for debt, specifically provide for standby support from such taxes for this purpose.

### THE CASE FOR A STATE GENERAL PROPERTY TAX

The abandonment of the State general property tax by nearly one-half of the States and the contraction of its use for State purposes to a minimal level by most of the others have relinquished to local governments a major tax that all of them can use; but the results have disclosed fallacies in the theory of separation of State and local sources of revenue.

Administratively, the withdrawal of the States from the general property tax has had some detrimental effects. It removed the most obvious need for statewide equalization of assessments, tended to make State supervision of local assessing even more perfunctory than it had been, and obscured the need for joint State-local responsibility for conducting, coordinating, and standardizing assessment administration. Some legislatures have been reluctant to appropriate money for the State's share of administering a tax that produced little or no State revenue. It must be said, however, that in a number of cases State responsibilities had been so badly met that there was little room for deterioration, and in some States such detrimental effects as did develop are being overcome by constructive State action. The necessity for statewide equalization of assessments for collateral purposes has been emphasized by the widespread development of equalizing school aid programs, and the more alert legislatures are realizing that skilled State participation in local property

tax administration can strengthen the tax and lessen the need for State aid from other revenue sources.

A main defect of the separation of sources policy that assigns the general property tax to be levied by local governments for their basic support is the failure of the distribution of taxable property in a State to coordinate with the distribution of population and the cost of local government. The inequity is intensified in many States by the highly subdivided local government structure. Two residential suburbs, for example, may have equal governmental needs, but the taxable property per capita in one may be vastly higher than in the other. A huge industry may enrich the taxing power of the taxing district which it dominates while its employees inhabit an adjoining district whose taxable property comprises mainly their modest dwellings. Among rural areas there is a similar lack of such coordination. Some well-to-do communities have been able, by incorporating as local governments, to insulate themselves from payment of a proportionate share of the property taxes levied in the State.

An increasing local awareness of this uncoordinated situation, particularly among small suburban communities, has induced local protectionist planning and zoning policies that are a hindrance to sound metropolitan area planning. The fractionalized character of the local government structure in metropolitan areas is in itself a deterrent to land use planning for the well-balanced economic development of such areas; but when the planning and zoning in each small community seek to produce a local economic balance that will hold down tax rates, i.e., are more or less dominated by local fiscal considerations, the important area wide

objectives are additionally thwarted. In proposing a partial solution for this problem through the levy of a State property tax for local apportionment, Lynn A. Stiles has observed that "The whole idea of 'economic balance' in so narrow a context is absurd. And if the tax structure is a force animating the drive for balance of this sort, then clearly something needs to be done about the tax system."<sup>14</sup>

How to moderate the inequalities in local property tax burdens that arise because of the varying local relationships between fiscal ability and public service needs is one of the really perplexing problems in State-local fiscal relations. By eliminating abnormally high tax rate areas at one extreme and opportunities for tax shelter in low tax rate areas at the other extreme, there would be fewer local communities facing the alternatives of deficient public services or excessive tax burdens, more flexibility for well-planned metropolitan area development, and the potential for a larger overall contribution from the general property tax to State-local revenues without injustice to any locality.

Expanding the jurisdiction of taxing districts has an equalizing effect. Some equalization is accomplished by the consolidation of school districts, and a few States provide for an equalizing county school tax to help support local school districts. Some consideration has been given to the creation of metropolitan area taxing districts for equalizing as well as revenue producing purposes, and there are a few large multi-county metropolitan districts with property

taxing powers that illustrate this effect.<sup>15</sup> The ultimate in this equalizing development would be a statewide taxing district; i.e., a state property tax could be levied at a uniform rate for local use, to be distributed in such manner as to help equalize the cost of providing locally administered public services that should meet minimum standards on a statewide basis.

Various means of using this device are worth consideration. State assessed public utility property might be taxed by the State at the statewide average rate in lieu of locally imposed taxes, as is done in Michigan and Wisconsin, with the proceeds distributed locally on some equitable formula. The States might take over the assessment of all industrial property, which has a notably uneven local distribution, and follow the tax procedure suggested for utility property. A great majority of the States purport to follow the equivalent of this device for public schools, but by means that are less satisfactory than the actual levy of a State property tax.

The need for equalization of the local property tax effort has been recognized increasingly by the States in the area of public school financing by their adoption of school foundation programs. The theoretical intent of such programs is to set a minimum standard for local school expenditure per pupil, require a uniform tax effort in all districts by the application of a specified tax rate to the equalized valuation, provide for State aid, usually from some nonproperty tax source, to supply the difference between the local tax yield and the standard requirement, and leave it to each district to raise

<sup>14</sup> Lynn A. Stiles, "A New Role for the State Property Tax," in *Revenue Administration, 1959, Proceedings of the Twenty-Seventh Annual Conference, National Association of Tax Administrators, Federation of Tax Administrators, Chicago, 1959*, p. 11.

<sup>15</sup> The largest illustration is the Metropolitan Water District of Southern California, serving virtually the entire south coastal basin, which is supported partially by the general property tax.



additional revenue if it wishes to conduct a more costly program.

What seems in theory to be a workable device for statewide equalization of a major portion of local property taxes turns out in practice to be defective in its operation in some States and usually is not only distorted from its equalizing purpose but is submerged in a cumbersome hocus pocus of school aid formulas that are completely unintelligible to the general public. In a number of States the mandated local tax rates are still based on unequalized or defectively equalized local assessed valuations, thus encouraging competitive underassessment. Where there is State equalization of assessments the basis in most instances is a fraction of full value which understates fiscal ability, and the laborious and costly task of equalization is directed primarily to interarea equalization, including equalization of assessing mistakes, rather than to improving the quality of local assessment.

Equalization of property tax effort is vitiated when wealthy school districts can meet the foundation standard by levying less than the mandated rate or are guaranteed specified amounts of State aid regardless of their high fiscal ability.<sup>16</sup> Prof. H. Thomas

<sup>16</sup> Roger A. Freeman, in his study of public school financing, states that "Because of the great diversity of formu-

James of Stanford University, in advocating a State property tax instead of mandated local rates, has observed that although "The mandated rates for local contribution to the foundation program were designed initially as an equalizing device, and are still so treated in serious legislative discussions . . . Manipulation of the rate in the several States today has little at all to do with equalization, but a great deal to do with shifting the incidence of school costs from property taxes to sales or income taxes or both."<sup>17</sup> The same authority indicates that in the equalizing grants:

. . . we find the lush, green jungle of bureaucracy in full development, with ratios running rampant, qualifying rates entwining with average daily membership and average daily attendance, and the feet of the unwary are constantly being caught up in little tendrils of pupil-teacher ratios, exemption provisions, administrative leeway, and grandfather clauses.<sup>18</sup>

as it is almost impossible to compute nationally what share of all State aid payments is actually applied to equalization. But it seems likely that not more than one-third equalizes, and it could very well be less." (*Taxes for the Schools*, The Institute for Social Science Research, Washington, 1960, p. 344.)

<sup>17</sup> H. Thomas James, "Implications of School Aid Apportionment Methods for Tax Administrators," *Revenue Administration, 1960, Proceedings of the Twenty-Eighth Annual Conference, National Association of Tax Administrators*, Federation of Tax Administrators, Chicago, p. 54.

<sup>18</sup> *Ibid.*, p. 53.

## Chapter 8

### THE LIMITS OF PROPERTY TAX PHILANTHROPY

In the admirably succinct words of one perturbed civic organization, "The clamor for tax exemption unfolds somewhat like a contagious disease. One specific exemption in itself may appear quite harmless. However, going back to the turn of the century, one exemption leads to another until today, including intangibles, more property has been taken from the tax base than now remains."<sup>1</sup>

This expression of concern over the decreasing generalness of the general property tax is well justified by the erosion of the property tax base that has occurred over the past half century or more and continues to occur. Total figures for tax exempt property are available only in a limited number of States, and these figures admittedly are only approximations; but quite obviously there is an enormous difference between the total value of all property in the United States and the value of property that actually is taxed. With a total assessed value of taxable property of less than \$2,000 per capita, and an assessed value of taxable personal property of only \$315 per capita, in 1961, the tax base for local general property taxation bears little resemblance to the Nation's affluence in property values. As compared with an estimated national wealth of \$1,682.1 billion in 1958 (a figure that does not include intangibles), the aggregate of locally taxable assessed valuation was \$355.7 billion in 1961 (inclusive of in-

tangibles).<sup>2</sup> Because of fractional assessment, the contrast is less extreme than these figures appear to indicate, but still great.

#### EXEMPTION POLICIES

Property tax exemptions have become so varied, and differ so greatly among the States, as to defy any simple classification. In a broad sense, they cover the exclusion of entire major classes of property, as when a State excludes all intangible personalty, or even all personalty, from the tax base. In many States there are exemptions of certain subclasses of major classes of property, as when a State taxes only certain kinds of intangibles, or excludes household goods and personal effects, or restricts the taxation of tangible personal property to business personalty. Many exemptions step down to sub-subclasses of property, as in the instance of restricting the taxation of household goods to household luxuries, or exempting growing crops, or poultry not more than 6 months of age and not kept for reproductive purposes.

There are, also, ramifying special exemptions, applying variously within classes of taxable real or personal property or both, that are conditioned on such factors as the identity of the owner or the nature of the owner's use of the property. Under this

<sup>2</sup> Estimate of national wealth by National Bureau of Economic Research; data for taxable assessed valuations from U.S. Bureau of Census, *Property Tax Assessments in the United States, op. cit.*

<sup>1</sup> League of Wisconsin Municipalities, *Readings on the Wisconsin Assessment Process*, vol. 1, 1961, p. 4.

type there are, in addition to the traditional exemptions for public property and the property of religious, educational and charitable organizations, special exemptions for homestead owners, veterans, aged, widows, orphans and the blind, and even more special exemptions such as those for individual industrial plants, the property of chambers of commerce and labor unions, "carnival organizations conducted as civic enterprises for the public welfare" (in Louisiana), and (in Rhode Island) the property to the extent of \$10,000 of the president and professors of Brown University.<sup>3</sup> Emphasizing further the infinite variety of exemptions, some may be temporary rather than permanent and some may be partial rather than complete, either through exemption up to a specified limit or through taxation at special low rates.

Underlying this still proliferous conglomeration of property tax exemptions there has been an arresting diversity of motives and purposes, actual and ostensible. Over the years there has been a considerable replacement of taxes on some classes of property by alternative forms of taxation, mainly for economic or administrative reasons. For example, income taxes have replaced property taxes on intangibles and severance taxes have been substituted extensively for property taxes on forests and minerals. The unadministrable or inequitable character of taxes on some classes of personal property has been the avowed reason for the exclusion of such property from the property tax base, but in some instances the more nearly genuine reason has been strong taxpayer

group pressure or reluctance to provide the quality of administration required. A formidable and growing assortment of exemptions represents indirect subsidies to various types of private institutions and organizations and various kinds of business enterprise. Some exemptions may best be designated as donations and awards, notably those exemptions for veterans that are not related to disability but are solely in recognition of public service.

The goal of tax justice, with redistribution of the property tax burden to give more recognition to unequal ability to pay, has had some part in the development of property tax exemptions; but too often what has seemed to mean more justice for one group has imposed injustice on other groups, or what has been adopted under the guise of tax justice has been merely the successful importunity of some politically influential pressure group, or the exemption has been merely the legislator-politician's means of purchasing popular favor at what seemed to be without cost to the State. In any event, as one searching study of the problem concluded:

The use of property tax exemptions for redistributing the burden is hindered by the difficulty of knowing where the burden lies and where it will lie after the change is made. Although this difficulty is common to all taxes, it is especially important for the property tax because of the size and universality of the burden.<sup>4</sup>

### RESTRICTING EXEMPTIONS

The seemingly endless process of narrowing the property tax base has progressed so far, and in such diverse directions, as to necessitate some forthright determination not only of where it should stop but how much of it should be repealed. Step by step,

<sup>4</sup> Twentieth Century Fund, Inc., *Facing the Tax Problem*, 1937, p. 296.

<sup>3</sup> These are a few examples of hundreds of miscellaneous exemptions, many more of which were cited by M. Slade Kendrick in "Property Tax Exemptions and Exemption Policies," National Tax Association, *Proceedings of the Fifty-First Annual Conference on Taxation*, 1958, pp. 84-98.

exemptions place heavier burdens on those still required to pay, or reduce the responsibility of local governments by inducing them to depend increasingly on fiscal aid. No brief commentary can attempt to deal with all the legal, administrative, economic, social, and political pros and cons of property tax exemption; thus attention is restricted here to certain types of exemptions whose use may be seriously questioned or at least needs more careful control.<sup>5</sup>

The kinds of exemptions that should be curtailed or abolished include: (1) exemptions that foster inequity and special privilege; (2) exemptions which are veiled subsidies to private interests that would be difficult to justify as frank State budget appropriations; (3) exemptions which are an ill-chosen and defective method of granting subsidies and awards and recognizing needs that may in themselves have been justifiable; (4) exemptions which unnecessarily and heedlessly complicate the tax system and add to the difficulty and expense of its administration.

### HOMESTEAD EXEMPTIONS

One of the durable by-products of the 1930's depression was homestead exemption, a benevolent device whereby owner-occupiers of dwellings and farms in a considerable number of States were freed from payment of all or part of the property tax that ordinarily would have been applicable to their holdings.<sup>6</sup> The encouragement of

home ownership was the ostensible justification for fostering this special privilege, but a more impelling influence was the condition of emergency under which many homeowners were threatened with loss of property through inability to pay their taxes. The remedy seemed to assume depression as a permanent circumstance.

Homestead tax exemptions or tax preferences, applicable with varying qualifications to owner-occupied dwellings and farms, were considered by around 30 State legislatures and adopted by 14 States in the 1930's. A few other States have made limited special applications of the device. The exemption procedure is to free homestead real property from payment of some or all taxes on up to a specified amount of assessed valuation. Eleven States provide exemptions,<sup>7</sup> Iowa uses a tax credit,<sup>8</sup> and Minnesota (which also uses an exemption) and West Virginia have classified systems

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ments on farms in 1919; Arizona and Nevada had long-standing property exemptions for widows; and there had been a number of small head-of-family exemptions such as New Mexico's exemption of \$200 on real and personal property. The practical effect of this exemption in New Mexico has been to eliminate the tax on household goods. According to the New Mexico State Tax Commission, "The assessment of household goods in New Mexico is a farce. The practice is widespread of valuing and assessing household goods at \$200. This amount is then wiped out by granting of the head-of-family exemption of \$200." The Commission suggested, as a practical method of tax simplification, elimination of both the exemption and the taxing of ordinary household property. (*Twenty-First Biennial Report*, 1956, pp. 16-17.)

<sup>7</sup> These States are, with the amounts of exempt assessed valuations: up to \$1,000—Oklahoma; to \$2,000—Alabama, Arkansas, Georgia, Louisiana; to \$3,000—Texas; to \$4,000 (full value)—Minnesota; to \$5,000—Florida, Mississippi. In Hawaii the exemption applies to the first \$1,500 plus part of the next \$3,500. In South Dakota the exemption is primarily an acreage exemption.

<sup>8</sup> Iowa has a homestead tax credit plan under which property taxes of up to \$62.50 annually (25 mills per dollar on up to \$2,500 of assessed value) are met from the State homestead tax credit fund, the qualified local taxpayers receiving a credit of the amount on their tax bills.

<sup>5</sup> The need for halting exemptions clearly does not apply to modifications of the tax base that are essential to the development of an administrable tax system, as discussed in ch. 3.

<sup>6</sup> The use of tax exemption to subsidize the small or specially handicapped homeowner was not a new policy. South Dakota and Wisconsin had experimented temporarily with homestead exemption after World War I; North Dakota had exempted all structures and improve-

that provide partial exemption for homesteads.<sup>9</sup> Two States, Michigan and New Mexico, voted down homestead exemptions by referendum in the 1930's and North Carolina and Utah have never adopted enabling legislation for authorizing constitutional amendments of 1936.

The exemptions range from \$1,000 in Oklahoma to \$5,000 in Florida and Mississippi. In several of the States the exemption has an acreage limitation, usually 160 acres for farms and one-half acre or one acre for dwellings. The exemptions vary also as to the taxes affected. In three States (Florida, Hawaii, and Oklahoma) they apply to taxes levied by all governments, while in five States (Alabama, Arkansas, Minnesota, South Dakota, and Texas) they apply only to State taxes. Since Arkansas has repealed its State property tax and South Dakota does not regularly levy such a tax, their homestead exemptions are no longer significant. In Georgia, Louisiana, and Mississippi the exemptions apply to all or most taxes except those of municipalities. (In Louisiana, however, they apply to New Orleans.)

For the six States in which local taxation of property is involved, the Census Bureau has reported an aggregate assessed valuation of homestead exempt property of \$6.8 billion in 1961. The exemption covered 44.5 percent of locally assessed real property

in Mississippi and over 30 percent in three other States.<sup>10</sup> In 1956, the aggregate for five States exclusive of Hawaii, which accounted for \$181 million in 1961, had been \$4.3 billion.

#### *Effects of Homestead Exemption*

The policy of homestead exemption involves a substantial amount of injustice. It starts out by awarding a special bonus to one class of property in the form of an increase in its capital value and then provides a continuing subsidy to this class at the expense of the tenant and business classes. Rented properties occupied by low income families help to pay the taxes from which homeowners—all homeowners, not just small homeowners—are freed, and business interests suffer hardship unless they are able to shift the tax increases to their customers and clients.

Since all of the States assess property at some fraction of full value, moreover, the value of homestead exemption is much greater than the law appears to indicate. On the basis of a 20 percent assessment ratio in Mississippi, for example, a \$5,000 exemption actually would give tax exemption to a \$25,000 dwelling.<sup>11</sup> A recent reexamination of homestead exemption in Florida revealed that on the basis of 1959 assessment ratios the \$5,000 homestead exemption was the actual exemption in only one county, which was assessing at full value, but that in the

<sup>9</sup> In Minnesota, where 13 classes of property are subject to varying rates of assessment ranging from 5 to 50 percent of "full and true value," the assessment ratio on the first \$4,000 of such value is reduced from 33½ to 20 percent on owner-occupied rural realty and from 40 to 25 percent on owner-occupied urban real estate. In West Virginia the exemption is accomplished by the State's classification of maximum tax rates under its constitutional tax limitation amendment. Owner-occupied residences and farms occupied and cultivated by their owners or bona fide tenants are subject to a maximum tax rate of \$1 per \$100 of assessed valuation as compared with maximum rates of \$1.50 and \$2 for other real property.

<sup>10</sup> The amounts of these homestead exemptions and their relation to the total assessed value of locally assessed real property in 1961 were (amounts in millions of dollars): Florida, \$4,213 (32.0 percent); Georgia, \$858 (33.7 percent); Hawaii, \$181 (8.3 percent); Louisiana, \$765 (34.7 percent); Mississippi, \$370 (44.5 percent); Oklahoma, \$418 (23.1 percent). (Figures based on U.S. Bureau of the Census, *Property Tax Assessments in the United States*, *op. cit.*)

<sup>11</sup> The Census Bureau found the median assessment ratio for nonfarm houses in 25 selected areas in Mississippi in 1956 to be 20 percent.

other counties the exemption actually ranged upward to nearly \$20,000 of market value.<sup>12</sup>

In those States where homestead exemption applies to local taxes the impact on local government of a much narrowed tax base can be very disturbing. Since the opportunity to curtail services and facilities usually is limited, it becomes necessary to redistribute much of the property tax load to nonexempt property, develop other sources of revenue, and resort to improvised and usually expensive methods of limited-obligation borrowing. The severity of the impact, moreover, is very uneven for different types of communities. A modest-type residential community or rural county with small farms of limited value would suffer more than a commercial center with a large nonexempt valuation. While homestead exemptions comprised 31.5 percent of total assessments in Florida in 1958, the range among the counties was from 12.7 to 52.2 percent.<sup>13</sup>

Three States safeguard their local governments from the damaging financial effect of homestead exemption, Iowa by treating the exemption as a tax credit paid from State funds and Louisiana and Mississippi by reimbursement for the loss of taxes. Under these arrangements the discriminatory subsidy remains, but its cost is met from various statewide sources of revenue.

Homestead exemption no doubt has offered some stimulus to home ownership, but other stimuli that are not unjust and not disruptive of local government have been available and home ownership has been able to make good progress in the States that have shunned this policy. It represents a

type of exemption that because of its inequitable discrimination has little or no justification, should not be permitted to expand in some new and more ingratiating form, and should be discontinued, preferably by stages, to avoid too harsh an adjustment for its beneficiaries.

### SUBSIDY EXEMPTIONS TO INDUSTRY

About a third of the States, mainly in the South and New England, authorize, or have authorized at one time or another, the granting of property tax exemptions to new industries or industrial plants, usually for 5 or 10 year periods. The purpose of such exemptions is to influence plant location and to serve as an instrument of interstate industrial competition.

The immediate effect of such subsidies is to benefit the recipient; however, they also harm competitors, place a burden on the taxpayers who have to carry the tax from which the beneficiary has been freed, and promote interstate tax warfare that endangers the development of fair and adequate tax systems generally. There is some doubt, moreover, that there is sufficient long-term benefit to the economy of the State to justify the cost imposed on the taxpayers and the possible hardship to non-subsidized industry. A thorough investigation of industrial tax exemption in Louisiana, where the program is State administered and there are good central records, developed the conclusion that:

- (1) tax exemption as a device for inducing new industrial expansion which would not otherwise occur has produced meager results in Louisiana;
- (2) the cost of the program in terms of lost revenue is out of proportion to the direct results obtained;
- (3) the 10-year industrial tax exemption program

<sup>12</sup> Wylie Kilpatrick, "Homestead Exemption Reexamined" in *Municipal Finance*, February 1960, p. 116.

<sup>13</sup> *Ibid.*

for new industry in Louisiana should be reevaluated.<sup>14</sup>

Authorizing local governments to grant industrial tax exemptions is unsound policy. Some communities may succeed in using the device for their local benefit, others may find only expensive disappointment; but in either event local decisions take no account of their possible detrimental effect on other communities in the State. In any event, substantial industries, capable of making a lasting contribution to the economy of a State, are less interested in a temporary property tax handout than in the existence of a well-balanced, equitably-administered State-local tax system and of good local public services maintained at reasonable cost.

Having the same economic effect of benefiting one group at the expense of other groups are subsidy exemptions or preferential taxes for entire industries. They may reflect a belief that a particular industry needs this stimulus, or stem mainly from a dominant influence in the legislature. Quite notably, many States grant various exemptions to personal property used in agriculture. The machinery, equipment, merchandise on hand and in process and other productive tangible personalty employed in agriculture are singled out for

full or partial exemption much more extensively than is the tangible personalty of manufacturing, and often so eclectically as to complicate the work of the assessor.<sup>15</sup>

The classification of property for taxation and its exemption from taxation in the interest of greater tax justice are praiseworthy objectives, but the bewildering diversity in the exemption and classification of agricultural personalty among the States suggests that in some States they represent piecemeal accretions that are poorly planned subsidies to agriculture, may sometimes favor one kind of agriculture at the expense of another, may discriminate against other types of industry, and may unduly and unnecessarily complicate tax administration.

## VETERANS' EXEMPTIONS

Some kind of property tax exemption for veterans is now provided by constitution or statute in about 32 States, though the categories and conditions are infinitely varied.<sup>16</sup> All of the States have residence requirements, although they are far from uniform. Typically, exemptions are contingent, among other things, upon honorable discharge from service in specified wars and campaigns, of which, for example, California lists 29 in its statutes. Exemptions based solely on service are granted to all veterans in 10 States and to veterans of wars prior to World War I in 5 others; but

<sup>14</sup> William D. Ross, "Tax Concessions and Their Effect," in National Tax Association, *Proceedings of Fiftieth Annual Conference on Taxation*, 1957, p. 221. The study covered 609 exemptions granted in 1946-50 involving new investment of \$355 million. On the basis of information received from 60 percent of the firms involved, Dean Ross determined that without the exemption Louisiana would have failed to obtain only about \$25 million of this new investment. He found the resulting annual loss in tax revenue to be \$3.1 million, or a total of \$51 million for the exemption period, assuming no change in tax rates. According to the biennial report of the Louisiana Tax Commission for 1960-61, the value of exempt manufacturing plants under 10-year contract was estimated at \$2,024,063,618.

<sup>15</sup> For a concise, factual study of the taxation of agricultural personalty, reference should be made to Harvey Shapiro, *Taxation of Tangible Personal Property Used in Agriculture*, Farm Economics Division, Economic Research Service, U.S. Department of Agriculture, 1962.

<sup>16</sup> For excellent factual and analytical summaries see: John O. Behrens, "Property Tax Exemptions for Veterans," in *Municipal Finance*, February 1960, pp. 122-129, and McGehee H. Spears, "Veterans' Property Tax Exemptions," in *National Tax Journal*, June 1958, pp. 129-137.

in 6 of these States, only if the value of the veteran's property (and in Idaho his income) does not exceed specified amounts. The majority of these States also provide larger exemptions based on disability, and the other States provide exemptions entirely on this basis, again with the qualification in several instances that the value of the veteran's property not exceed a specified amount. Ten States in all have such property qualifications, with ceilings ranging from \$3,600 to \$8,000. Some provide a rising scale of exemptions depending on the degree of disability and several States grant exemptions only to the severely disabled.<sup>17</sup>

In over one-half the States the exemption applies to all classes of property, in most of the others to the veteran's homestead or homestead and personal property, and in Oklahoma (which has a general homestead exemption) to \$200 of personal property only. The general scale of exemptions based only on service ranges in flat amounts from \$500 to \$3,000 of assessed valuation, though Iowa varies the amount between these extremes for different wars and campaigns. Disability-based exemptions run as high as \$10,000 for severe or total disability in several States and to the full value of the homestead in a few States. With few exceptions exemptions extend to tax levies by all governments. In the one instance in which the exemption applies only to State taxes, Arkansas, the State has abandoned the property tax for State purposes.

Most exemptions extend over the life of

<sup>17</sup> This summary overlooks the many special arrangements in individual States. For example, in Vermont there is full homestead exemption for veterans of wars prior to World War I and a \$2,000 homestead exemption for veterans of later wars who are 50 percent or more disabled, while in New York a \$5,000 exemption, which does not apply to school taxes, is extended only to real estate purchased by the veteran with pension, insurance, and other government benefits.

the veteran, quite commonly are extended to his widow and minor children, and sometimes to his father or widowed mother. Wyoming, however, has taken the position that exemptions based solely on service are a form of bonus and should be limited in dollar amount. It amended the law in 1955 to limit the tax exemption to \$800 but continued the exemption of up to \$2,000 for disabled veterans. Louisiana's exemptions for veterans of World Wars I and II and the Korean War also are for limited periods.

The national amount of veterans' exemptions is not known, as some States do not collect and report the data or do not report data separately for different kinds of exemptions; but 15 States reported to the Census Bureau a total of \$2.6 billion in 1961, a figure which appears to represent the bulk of the national total. This amount is 24 percent higher than the closely comparable total of \$2.1 billion reported to the Census Bureau for 1957. All States reporting in both years showed increases during the interval with the exception of Wyoming, which experienced a decrease from \$17 million to \$11 million.

#### *The Defects of Veterans' Exemptions*

Property tax exemption is the wrong way to finance veterans' continuing bonus and disability payments. This method, to be sure, is merely an expansion of traditional procedure and, politically, is a rather painless way of making big annual expenditures since it can be done without budgeting and without accounting; but these doubtfully favorable features are offset by some clearly unfavorable features.

If these benefits to veterans are socially desirable they should not be contingent on property ownership. Under the present dispensation the propertyless veteran gets



nothing and the veteran whose sole taxable possession is an old automobile worth \$300 does not fare nearly as well as his more affluent comrade.

Since most exemptions are in terms of assessed value they have an indeterminate value that varies from time to time and from place to place within individual States when there are underassessment and a lack of interarea equalization. If, for example, a veteran's property is assessed at its full value of \$16,000 his \$2,000 exemption saves him one-eighth of the tax, but if the property is assessed at \$4,000 his saving is one-half of the tax. Veterans' exemptions, like homestead exemptions, generate pressure for underassessment, particularly when there is a property value ceiling on eligibility.

The method of paying for this annual obligation is inequitable in that the cost is placed on the property tax bills of the owners of nonexempt property unevenly. Studies have shown that the impact on some taxing districts is much heavier than on others.<sup>18</sup> A few States have recognized this defect by making some reimbursement to their local governments.

Finally, local property tax administration, which at best is a highly demanding job, has imposed on it extraneous and complicating responsibilities. The assessor has to check the eligibility of veterans and their heirs, which often means not only the service record but such factors as the degree of dis-

ability and possible disqualification through excess property ownership, and the complications continue through the record keeping, collection, and accounting procedures.

All of the foregoing defects could be eliminated by replacing the granting of benefits to veterans through tax exemption with a State administered benefit program based on merit and need instead of property ownership, and financed by general State revenues or by the levy of a State property tax. Use of the latter financing method would give official recognition to the present de facto use of property taxes for this purpose and divest it of its gross inequities.

### INSTITUTIONAL EXEMPTIONS

The property tax exemptions for non-profit religious, charitable, and educational institutions are so well guarded by ancient tradition as to be almost impervious to question. The theoretical justifications for these classes of exemptions are equally traditional. In the instance of educational, health, and welfare institutions there is the assumption that they are performing public services which otherwise the government would be required to undertake, or are advancing cultural and social causes that the government should wish to encourage. Because of the separation of church and State, exemptions for religious institutions require a somewhat different justification—that such institutions foster morality and thus promote the welfare of the State. The right to some of these exemptions is safeguarded in many State constitutions.

Over the years the kinds of organizations that are affected with a public interest, or have been able to persuade State legislatures that they have this status, and therefore have received exemption from paying

<sup>18</sup> A report on veterans' tax exemption to the California State Legislature in 1958 disclosed that the ratio of the total value of veterans' exemptions to the total State assessed valuation in 1956 was 4.0 percent, but ranged from a low of 0.43 percent to a high of 6.5 percent among the State's 58 counties. Also, the number of persons to whom exemptions were granted ranged among the counties from 2.69 to 10.12 percent of the population. (Subcommittee on Veterans Tax Exemption, *The California Veterans Tax Exemption*, 1958, pp. 44-45.)

property taxes, have been steadily expanding. It seems to have become progressively easier for almost any organization that engages in some activity of social or cultural significance to make the tax-free list—and once on the list its subsidy tends to be permanent. The categories of organizations whose real and personal property is now exempt either in all States or a considerable number include: (1) religious, including affiliated organizations; (2) educational and cultural; (3) health and welfare; (4) fraternal and benevolent; (5) business and professional, such as chambers of commerce, bar associations, medical associations, farmers' organizations, and labor unions; and (6) veterans' organizations. Such exemptions may be restricted to property employed directly in nonprofit activities, or they may be extended also to property earning income for these activities.

This, in effect, adds up to a large, concealed government subsidy for numerous classes of nonprofit institutions and organizations ranging down from those whose services clearly are of a public nature to those whose activities may be socially desirable but also may be intermingled with professional and business interests or even subsidiary to such interests. No nationwide data are available, however, on the value of these indirect subsidies. The constitutions of a few States and the laws of a number of others require that such exempt property be listed and assessed, but the tax commissions and tax departments of only a few States compile, evaluate and publish these significant figures. In California, which publishes clearly informative data, the assessed value of exempt institutional property in 1961 was equal to 2 percent of the assessed value of taxable

property.<sup>19</sup> In New Jersey, which publishes exemption data for each taxing district, the aggregate approached 8 percent of the net taxable valuation in 1961. In Connecticut, John F. Tarrant, research director of the State Tax Department, estimated in 1961 that the \$1.7 billion total of all exempt property represented an annual revenue loss to the municipalities of \$62.5 million or nearly \$25 per capita, about 30 percent of which represented institutional exemptions.<sup>20</sup>

There is little opposition to government aid for private, nonprofit institutions clearly affected with a public interest, but there has long been a strong feeling that institutional tax exemption has been carried beyond its basic purpose and has been abused, and also some feeling that tax exemption is an undesirable method of providing such aid. The method may be questioned for three reasons. The exemptions must be absorbed not by a statewide tax base but by individual local tax bases. The impact tends to be very unequal and in some instances a community must bear the exemption for an institution that serves a much wider area. Second, the State legislature may feel unduly benevolent when it can make a generous contribution to some worthy private cause without any obvious cost to the State. The legislators might be more discriminating if the gift had to appear in the budget. Third, the legislature actually is imposing forced con-

<sup>19</sup> The annual reports of the California State Board of Equalization show, for each county, the number and assessed value of each of the following classes of exempt property: veterans, church, college, schools below college grade, hospitals, other welfare. In 1961 the aggregate for the State equaled 5 percent of the assessed value of taxable property; for individual counties the range was from 0.8 to 8.2 percent.

<sup>20</sup> From an unpublished paper, *Exemptions—Erosion of the Property Tax Base*, presented at the Forty-seventh Annual Conference of the Governmental Research Association, Sept. 25, 1961, Hartford, Conn.

tributions on the taxpayers of the State's communities without their consent and outside local budgetary processes. As a joint committee of the New York State Legislature expressed it some years ago:<sup>21</sup>

Tax exemption does give a subsidy, but the trouble is that it is a blind subsidy, controlled by accident. And it is, moreover, a compulsory subsidy which cannot be reviewed and fixed by those who pay it as sound finance demands.

Outright government grants, as an alternative to waivers of property taxes, have often been urged for institutions whose services clearly are of a public nature, together with abolition of exemptions for organizations for which grants could not be justified. This policy would avoid the inequity imposed on some local communities by the present system and would replace hidden subsidies by accountable public appropriations. Opponents of this change, however, argue that a system of grants would subject some institutions to governmental regulation and pressure from which they should be free. Prof. M. Slade Kendrick, in a cogent exposition of this point of view, said:<sup>22</sup>

. . . exemption from taxation is the only way that the government can help the institutions concerned without making them lose their independence of action. A subsidy of a university or church would be a matter of public record, for an expenditure would have been made. On the other hand, the value of an exemption is concealed. But for the purposes thereby served, the very merit of an exemption lies in its hidden nature. No money is paid out of the treasury, no loss of revenue is computed, and no competition between institutions is engendered in the State legislature or the city council. The government simply refrains from taxation. As a result, each institution is helped, is on the same footing as the others, and is under no pressure to change its operations.

<sup>21</sup> Quoted in New York State Constitutional Convention Committee, 1938, *Problems Relating to Taxation and Finance*, Albany, 1938, p. 225.

<sup>22</sup> M. Slade Kendrick, *op. cit.*, p. 88.

Although the use of grants may be undesirable in some instances, there is no good reason why the validity of each type of institutional exemption should not be subject to the test of whether it would justify a continuing grant—in other words, would it be a wise permanent expenditure. State legislatures and the public, however, are unlikely to consider seriously so strict a criterion unless they have far more carefully analyzed data regarding the magnitude and effect of this creeping tax base erosion than are now available to them in the great majority of States.

A forthright solution of the institutional tax exemption problem—and one that has been proposed in more than one State constitutional convention—would be to do away with such exemptions entirely. This proposal has had limited support thus far; but, as one apprehensive commentator has warned, if the States are unable to control the exemption flood "the only alternatives we will have open to us are either to abolish the tax or eliminate exemptions, and I rather think we will have to do the latter."<sup>23</sup>

## TAX EXEMPTION FOR THE AGED

An emerging category of property tax exemption that promises to call for decisions in numerous State legislatures is tax exemption for elderly property owners. Adopted in a few States and under discussion in others, the proposal has sentimental appeal, can be a persuasive addition to political campaign promises, and offers an ingratiating means of lightening the financial problems of that portion of elderly citizens that owns homes.

Tax concessions or credits for the aged

<sup>23</sup> William O. Winter, "Tax Exemption of Institutional Property," in *Municipal Finance*, February 1960, p. 146.

are familiar features of the Federal income tax and of some State income taxes, but they appear in the property tax systems of only four States. Massachusetts has long had an exemption of up to \$2,000 of assessed valuation on homes occupied by widows, by minors whose fathers are deceased, and by persons over 70 years of age who have owned and occupied the property for at least 10 years, and Maine, an exemption of up to \$3,500 for the property of aged, infirm, or indigent persons. Both Indiana and New Jersey recently have adopted property exemptions for the aged that are contingent on a means test. An alternative plan whereby, at the option of a homeowner over 65, property taxes could be deferred until death or sale of the property was proposed by the Interim Tax Study Committee of the Oregon State Legislature in 1958.<sup>24</sup>

Indiana's old age property tax exemption law, adopted in 1957 and amended in 1961, permits an exemption of \$1,000 of assessed valuation on real property owned and occupied by residents aged 65 or more, provided the total annual income of the applicant and spouse does not exceed \$2,250, the value of the property does not exceed \$5,000, and the applicant receives no other exemption from the property tax. In filing the required application with the county auditor, the applicant must submit, among other things, copies of gross income tax returns for both husband and wife. The State's new requirement that real property must be assessed at 33½ percent of full value gives some indication of the value of the exemption.

The New Jersey constitution was amended in 1960 to provide an exemption

of not to exceed \$800 of assessed valuation for real estate owned and occupied as a residence by New Jersey citizens over 65 years of age, domiciled in the State for not less than 3 years, and having income not in excess of \$5,000 per year. Because of issues not clarified in the amendment and the enabling act of 1961, the State attorney general has ruled that the \$5,000 income limitation of a claimant does not apply to the income of his or her spouse, and that a person receiving the \$500 veterans' exemption is not eligible to receive the exemption for the aged as well.<sup>25</sup>

Some aged home owners undoubtedly present a special welfare problem, but that property tax exemption is the best solution is questionable. The contraction of the property tax base, some of it unjustifiable, that already has occurred should be a warning against impulsive decisions and failure to weigh alternatives. If this method of subsidy for the property-owning aged is chosen, it should at least (1) have an accurately defined rather than a nebulous value; (2) be easily administrable; (3) be as equitable as possible for those who have to pay for it; and (4) be clearly identified as a cost of government. The recently adopted exemption systems fail to meet these specifications.

All of these factors are attainable. (1) Basing the exemption on market value, as systematically determined by a State agency, permits a uniform and accurate definition and application of legislative policy as to the size of the exemption. (2) The local property tax administrators have enough to do without being made welfare investigators. A uniform exemption without a means test, following Federal and State income tax

<sup>24</sup> Several other States have exemptions related to disability or subsistence. At least 11 States provide exemptions for the blind, only 4 of which have means tests. At least five States provide exemptions for widows and three for orphans.

<sup>25</sup> *Annual Report of the Division of Taxation, 1961*, p. 22.

policy, provides good flexibility of benefits in two ways—the smaller the homeowner, the larger is the exempt percentage of his tax bill; the larger the homeowner, the more he must contribute toward paying other exemptions. (3 and 4) The proponents of this method of subsidy have been following a policy which, in effect, holds that it should be paid from property taxes, but that it should be concealed and the inequitable distribution of the cost disregarded. Overlooked, perhaps unwittingly, is the heavier impact of the resulting shift in tax burden on the taxpayers of poor residential communities and on communities that happen to have above-average percentages of eligible elderly homeowners. To avoid this concealment and inequity, the State should reimburse each local taxing district for the tax loss represented by the exempt property.

#### FRITTERING AWAY THE TAX BASE

"It seems to be part of our national psychological heritage," observes Dr. Mabel Walker, "to consider property tax exemption as an ideal means of promoting worthwhile enterprises, dispensing charitable aid, furthering social reforms, or showing esteem and gratitude. There is little or no recognition of the fact that many of these objectives could be more effectively, more economically, and more equitably achieved through a direct and visible subsidy."<sup>28</sup>

The questions and criticisms raised in the foregoing discussion of property tax exemp-

tions are not concerned with the exclusion and classification that may be necessary to produce a manageable and reasonably equitable property tax system. They are directed to the perennial give-away system that is confusing tax administration, frittering away the tax base, and unequally burdening local governments by yielding to special pressure groups, by shifting the tax burden without due regard for equity and justice, by the reckless misuse of exemptions for purposes which, while they may be desirable, could be better accomplished by other means, and by the piling up of concealed subsidies with little regard to their mounting cost and its effect on the local governments and the narrowing group of full-time taxpayers.

Local public officers responsible for the financial welfare of their governments, State administrators charged with the supervision of local finance, and trained observers concerned with the role of the property tax as it affects both State and local government are perplexed and disturbed by the endless inroads on the property tax base. One distinguished tax economist concluded a very discerning evaluation of the growth of property tax exemption with a warning that should be well heeded by the makers of State-local fiscal policy:<sup>29</sup>

It seems quite possible that the new sources of revenue needed so desperately by some local authorities are not to be found in new taxes or increased State aid; rather, they will be found in more equitable assessments and in restoring to the assessment rolls some of those categories of property now subject to reduced levies or none at all.

<sup>28</sup> Mabel Walker, "Land Use and Local Finance," in *Tax Policy*, XXIX (July-August-September, 1962), pp. 9-10.

<sup>29</sup> Mabel Newcomer, "The Growth of Property Tax Exemptions," *National Tax Journal*, June 1953, p. 128.



# **PART III**

**THE ROLE OF THE STATES IN PROVIDING COMPETENT  
ASSESSMENT ADMINISTRATION**





## Chapter 9

### ORGANIZATION FOR EFFECTIVE ASSESSMENT ADMINISTRATION

Good assessment administration, which is fundamental to a good property tax system, is nonexistent in many areas. For this reason the property tax is sometimes called the most inefficiently administered tax in the United States. It would be more accurate to say, however, that it has the most uneven quality of administration, for the results range from very satisfactory in some assessment districts to unbelievably poor in others. Good administration is demonstrably feasible but too often it fails to materialize.

This is a condition which no State can afford to tolerate. Since the State has created the tax and has placed reliance on it as one of the main components of the State-local revenue system, it has the responsibility for assuring a uniformly high quality of property tax administration throughout the State. There is too much urgency for salvaging this vital financial resource of State-local government to permit vested interests and local home rule traditions to stand in the way. Actually, there can be no better contribution to genuine local home rule than the assurance of a sound, equitable property tax base for every community.

Basically, each State faces a formidable administrative problem—a problem mainly of organization and personnel. The assessment of property for taxation is a technical administrative function which can be performed competently only by well-trained specialists using all of the appropriate administrative techniques. Entrusting this

job to a nonprofessional is like assuming that almost any reasonably intelligent citizen can audit a municipality's accounts, handle its engineering, or administer its public health. Part of the solution, therefore, involves the successful professionalization of the assessment function on a statewide basis. Equally important is the development of an administrative organization within which the professional staff can work effectively and which permits efficient statewide coordination and supervision.

The solution of the organization problem means different things to different States. In a few it involves merely refining or perfecting the existing setup. In a number of others the problem is mainly that of eliminating certain weak features of an otherwise reasonably satisfactory system. In many States, however, all or most of the principles of good organization are lacking, or are recognized so nominally as to be virtually nonexistent, leaving nothing short of a drastic revamping of existing arrangements as the way out. Suitable answers to the problem also will vary among the States, depending on such factors as the existing structure of government and pattern of authority, nature and distribution of taxable resources, homogeneity or heterogeneity of the economy, and distribution of the population. Three possible methods of administration call for consideration:

1. Complete centralization of property tax administration.
2. Complete centralization of assessment admin-

istration with tax collection and enforcement handled locally.

3. Well coordinated joint State-local administration.

### CENTRALIZED PROPERTY TAX ADMINISTRATION

Under a system of centralized property tax administration a central State agency assesses all property, bills and collects the taxes, and disburses the proceeds of all locally levied taxes to the respective local governments. There is no interference with local budget policy. Each local government levies the amount of property taxes that it wishes, within such limits, if any, as may be prescribed by law; the State merely provides professional services for administering the tax. This arrangement is a less than radical innovation as the State merely undertakes what some large counties have long been doing.

The State of Hawaii has such a system in successful operation, developed over its years as a territory. The property tax, restricted to real property, is used only by local governments but is administered by the State's comprehensive Department of Taxation, which is headed by an appointive director of taxation. Assessing is handled by one of the Department's major divisions, the real property assessment division; but, for economy and efficiency, the collection division (which is in charge of all of the Department's collections and accounting) provides electronic data processing that includes, for property tax administration, preparation of assessment lists, notices, tax rolls and bills, etc., and programing and processing for statistical and research projects.

For a detailed analysis of the organization and methods of this centralized operation,

reference should be made to volume 2; but it may be noted that the assessment division is professionally staffed under civil service jurisdiction, has an active technical services and research section, has employed technical consultants from time to time and made sound use of their recommendations, does good quality assessing, and has been improving the professional quality of its work, and through district offices under central supervision is able to maintain reasonably uniform assessment standards throughout a difficult jurisdiction that includes eight principal populated islands. The convenience and protection of the local taxpayers are served by these district offices, by a board of review of local residents in each county appointed by the Governor, and by a tax appeal court. Although Hawaii does not use the property tax for State purposes, the State legislature recognizes its importance in the overall revenue system by adequate financing of its administration. No charge is made to local governments for this service.

#### *The Case For and Against State Administration*

Competently conducted central administration of the property tax offers a number of advantages.

1. It permits the complete professionalization of assessment administration. This would not better the high professional standards that already exist in some local assessing districts in numerous States, but would extend them on a statewide basis. It enables the flexible use of specialists wherever needed, thus eliminating the present handicap of local districts unable to afford large and diversified staffs. It makes the job of assessor an attractive career profession through opportunity for advancement.

2. It provides a direct, uncomplicated method of assuring a satisfactory degree of equity in assessment among classes and within classes of property throughout the State through the use of an integrated professional staff following uniform methods and procedures under central direction, reinforced by continuous valuation research that the scale of such an operation would both demand and facilitate. It combats discrimination and abolishes the interlocal economic warfare of competitive underassessment.<sup>1</sup>

3. It eliminates automatically the confusion and economic inconvenience caused by the varying levels of assessment among a State's assessing districts and also does away with the present costly need for superimposing on the established organization for assessment administration, State agencies for equalization and for providing a modicum of training for unskilled local assessors.

4. It provides a simple solution for the problems of assessment caused by properties that lie in more than one local assessing district, are migratory in character, or require data for their appraisal that are not readily available to local assessors. Central assessment of some of these classes of property has already provided a partial solution, but too often without coordination of State and local assessing standards.

5. Centralization for the preparation of assessment and tax rolls, tax bills, etc., mailing, record keeping and accounting can obtain for the entire State the economy, accuracy and speed of electronic data processing facilities that are now available only to large local districts.

<sup>1</sup> For enlightening comment on local tax wars see Mabel Walker, "Local Tax Competition Within Metropolitan Areas," *Tax Policy*, XXV (July 1958) and "Land Use and Local Finance," *op. cit.*, pp. 42-43.

There are, however, a number of possible disadvantages, actual and conjectural, that must be considered. To the extent that they cannot be overcome they need to be measured against the magnitude of the anticipated advantages.

1. Centralization might inconvenience many taxpayers. This defect can be avoided by maintaining district offices, deputizing local finance officers as collection agents, and making provision for meaningful observance of the taxpayer's right to be heard.

2. Central assessment means loss of the local assessor with his personal contacts and presumed intimate knowledge of local conditions. The case for the truly skilled local assessor is strong, but in many areas he does not exist. Furthermore, the professional staff of the central agency would use the same methods and tools that the local professional employs and, with the support of central valuation research and a more comprehensive view of varying community conditions, might be in a better position to make comparative judgments. It is worth noting that when local assessing districts undertake comprehensive reassessments they usually employ outside professional appraisal firms.

3. There is danger that the central agency would become unwieldy, financially wasteful, time serving, and politically dominated. This is like saying that a State government is not competent to govern; and, without question, any State government to which such a statement applies would be a poor candidate for this function. There are too many well organized, professionally staffed, skillfully directed State administrative agencies among the States, however, to justify any sweeping assumption of such danger. The kinds of organization and control that safeguard the integrity of these

agencies would be applicable to centralized property tax administration.

4. The dissociation of central assessment administration from the local taxing districts might result in irresponsiveness to the needs of individual local governments. This would be quite probable if the central assessing agency were permitted the extralegal dictation of local taxing and borrowing power that is now tolerated for local assessors and State regulatory agencies that set and equalize levels of assessment without regard to law. The sole function of the central assessment agency should be to appraise all taxable property without discrimination at its market value. The imposition of safeguarding controls that would assure such performance within a reasonable range of tolerance is entirely feasible. This uniform determination of taxable values throughout the State would go far in freeing assessing from its disturbing policy aspects and making it the purely administrative function that it should be. Regulation of local finance and concern for local fiscal needs would then rest clearly where they belong—with the State legislature.

Potentially, central administration of the property tax is a superior method of overcoming the weaknesses that beset the management of this function. No State would be justified in abandoning its traditional organization and adopting a system of State administration, however, unless it had the prerequisites for establishing and maintaining a clearly superior system—one that at least met the high standards attained by the minority of local assessing districts in the United States with outstanding records of performance. This would rule out States with archaic governments suffering from a lack of well integrated fiscal organization

and diffusion of administrative control. On the other hand, for any State with a background of competent administration, especially fiscal administration, responsible central executive authority and respected leadership, there should be little question of ability to handle the undertaking successfully.

#### CENTRAL ASSESSMENT ADMINISTRATION

Under fully centralized assessment administration a State agency lists and appraises all taxable property and certifies the valuations to local officials. Using this State determined tax base, the local officials prepare the tax rolls and bill and collect the taxes. This clear-cut division of functions makes property assessment exclusively the responsibility of one central agency instead of leaving it variously divided between State and local agencies as it is now in most States. While this arrangement falls well short of the complete centralization of property tax administration discussed above, it does make the State directly responsible for administering the most vital, and presently most unsatisfactorily handled, feature of the administrative process for this tax.

A State could assume this single function more readily than the overall administration of the tax. Most States already are engaged in some central assessment, a few States have gone quite far in this direction, and some States have, additionally, strong nuclei for the required administrative organization in their professionally staffed agencies for the supervision of local assessment. The problems of transition would require some ingenuity to work out, but they should not involve the displacement of any competent local assessors as the new central agencies would need the services of these people.

Central assessment, the pros and cons of which have been considered in the foregoing discussion of complete central administration, is a more simple and direct method of obtaining the statewide assessment standards that are needed than the movement for better State supervision and equalization that is now being promoted energetically by several States; but it has the policy handicap of being a more uncompromising departure from traditional ways of doing things.

The outlook as to actual need, however, calls at least for the expansion of central assessment. The dispersion of industry into scattered small communities, for example, demands assessing techniques that the local assessors do not possess, and the fiscal ability to employ competent personal property appraisers as well as real property appraisers on local staffs is limited to large assessing districts. Thus central assessment may develop by accretion, particularly if State supervisory agencies are strengthened and gain the confidence and esteem of the public. It may be that some combination of central assessment and supervised local assessment will provide a reasonably adequate solution of the assessment problem in some States.

Local assessment districts that are large enough to maintain staffs professionally equipped to appraise all classes of taxable real and personal property and have well-established records for high-quality assessment would be understandably skeptical of any proposal that they relinquish the function to a central agency unless they were convinced of its clear advantages for them as well as for the State as a whole. Since the existence of such districts is assurance that high-quality assessment is feasible, their cooperation might help more than

their elimination in reaching statewide objectives. As shown in chapter 4, however, they are disappointingly few in number, the Census Bureau having found that in 1956 only slightly more than one-fifth of the 395 local assessing areas of 50,000 population and more surveyed were assessing even the relatively simple classification of single-family dwellings with a reasonable degree of uniformity. (The 1962 Census of Governments indicates some improvement on this score. See chapter 4, footnote 3.)

There are some States which could make the transition to central assessment, and even to full central administration of the property tax, with much more facility than others. Among them are the relatively small, compact States and the States that already have been moving in this direction through increasingly competent State supervision of local assessing. In those States where local assessing is preponderantly an inequitable muddle, a commonsense course would be to scrap the local system, instead of engaging in long and costly efforts to salvage it, and proceed directly to a system of central assessment or complete central administration. That there are such States—perhaps as many as one-third of the total—became dismayingly evident in the Census Bureau's assessment-sales ratio studies of 1957 and 1962.<sup>2</sup>

Well-sponsored proposals for the adoption of complete central assessment have been made in several States in recent years, notably in California, New Mexico, Rhode Island, and Wisconsin. In California one proposal came from city officials. At the 1946 conference of the League of California Cities a resolution was adopted calling for an amendment to the State constitution which

<sup>2</sup> See ch. 4.

would transfer to a State agency having jurisdiction only over tax matters, the responsibility for assessing all property subject to ad valorem taxation. According to a senate interim committee, "This proposal aroused strong opposition among county assessors and various business groups. No such amendment was submitted to the electorate, but public attention was focused on the inequality of property tax assessments . . ."<sup>3</sup> In its 1958 report the New Mexico State Tax Commission declared:<sup>4</sup>

All assessing authority should be vested in one body or department whether it be the tax commission or any other agency established for that purpose, with the idea of standardization of assessments and a more practical approach to achieve equalization than the present method of having 32 assessing officers at the local level.

A Rhode Island State fiscal study commission, reporting in 1959, recommended that the State take over full administration of the property tax.<sup>5</sup> In Wisconsin, the

Metropolitan Study Commission of Milwaukee, in a study of property tax administration, concluded among other things, in a 1958 report:<sup>6</sup>

Since assessment of property is a highly skilled technical matter in which uniformity of procedure is very important, the committee feels that a uniform approach cannot be obtained without centralized administration. Because of the importance of the property tax statewide, complete centralization ultimately in the property division cannot be avoided . . .

Any system of central assessment administration would need safeguards against its deviation from the objective administrative standards prescribed by law. The best protection would rest in the character and control of the State agency entrusted with this function—considerations that are discussed in the following chapter. Additionally, publicity and audit are protective devices that can be peculiarly effective in assuring continuity for uniformly high standards of central assessment. The law should require the annual publication, in a form clearly understandable by the taxpayers, of the results of assessment ratio studies by the assessing agency, disclosing the degree of assessment equality obtained within classes and among classes of taxable property.<sup>7</sup> It should require, also, periodic independent audits of the central agency's performance and the agency's own reports of its performance by qualified statisticians.

industry to the State." (Special Commission to Appraise the Financial Operations of the State Government and the Matter of State-Local Financial Relations, *State-Local Relations in Metropolitan Rhode Island*, 1959, vol. II, pp. 371-380, 460.)

<sup>6</sup>Quoted in Samuel B. Stewart, "Can We Make the Property Tax a More Effective Fiscal Instrument?" in National Tax Association, *Proceedings of the Fifty-First Annual Conference on Taxation*, 1958, p. 456.

<sup>7</sup>The feasibility and uses of such studies have been discussed in ch. 6.

<sup>3</sup>Report of the Senate Interim Committee on State and Local Taxation, *State and Local Taxes in California: A Comparative Analysis*, April 1951.

<sup>4</sup>*Twenty-Second Biennial Report*, 1958, p. 68.

<sup>5</sup>In a recent study of State-local fiscal relations in Rhode Island by the Institute of Public Administration for a State commission created to study this and other fiscal problems, the Institute recommended complete centralization of property tax administration "in a single State agency professionally organized and equipped for the job." It was indicated that the State, because of its excellent administrative organization, "was in a good position" to provide such an agency. The Commission, after review of the Institute's findings, recommended to the Governor and the legislature "that the State take over the assessment and administration of the property tax, to improve its fairness and workability."

"This centralizing proposal is made," the Institute said, "in spite of the ability of Providence and the larger other units to do a good-quality, low-cost job because it is believed to have advantages for them as well as for the municipalities that are too small to afford scientific property tax administration." Of special pertinence because of the State's static economy was the cited advantage that "The establishment of a uniformly high quality of assessment, and a uniform level of assessment, throughout the State would aid in the attraction of additional business and

## JOINT STATE-LOCAL ADMINISTRATION

Joint State-local administration of the property tax had its origins over 100 years ago when the States, in addition to providing for local, and sometimes county, boards of review, began setting up ex officio State boards of equalization to equalize assessments among local assessment districts for State tax purposes. This arrangement spread to most of the States and in the 1870's and 1880's many of the States moved further into property tax administration by centralizing the assessment of railroad property under the boards of equalization or newly created boards of assessment, also mostly ex officio. Before long there was a beginning of State assessment of the property of other types of public service enterprises. These developments appear to have augmented State property tax revenue somewhat, but without contributing much to the quality of assessment administration.

Before the close of the 19th century the State tax commission began to emerge as an improved type of State agency for bolstering administration of the property tax, still the main source of State revenue. These agencies were headed by full-time commissioners, usually appointed, and in addition to the function of assessment equalization they generally were given some authority over local assessment administration. Usually they took over the functions of the earlier ex officio boards; but in some instances the latter continued to operate, particularly when they had constitutional status, thus dividing State administrative responsibility for the property tax.

Over the past 50 years the States' arrangements for their share in the administration of the property tax have been

influenced by the gradual modernization of State fiscal administration and the replacement of the property tax by other taxes for State purposes. The present State organization for tax administration ranges from a considerable diffusion of responsibility in some States through tax commissions with expanded jurisdiction in many others to a number of integrated tax departments headed by single appointive commissioners or directors. Property tax administration, once the main reason for creating tax commissions, is now overshadowed by the management of the other taxes that supply the bulk of State revenue; but it still finds a prominent position in the administrative structures of some States and receives some recognition in most of the others.

Undoubtedly the decline in State use of the property tax lessened the States' feeling of responsibility for improving its administration, but all States except Delaware, Pennsylvania, and Hawaii (where the tax is State administered) designate some agency to supervise local property tax administration. With belated recognition that the State governments still have a vital stake in uniform and reliable property assessment, there is underway, moreover, a rather widespread movement to strengthen these agencies, or even to create new ones, and in some States there has been recent extension of central assessing.

Where to locate property tax supervision and central assessment in a State's organization for fiscal administration is a question that has had a diversity of answers, depending largely on such factors as the degree of streamlining that the overall organization has received, the extent to which traditional organizational features have survived, and the degree of importance that a State attaches to its property tax responsibilities.

Most commonly these functions are located in a division or related divisions under a tax commission or its equivalent (usually appointive but with a few exceptions) or under a tax commissioner or director of revenue (also usually appointed) who commonly heads a more or less unified tax department. Illustrating the extreme range in types of organization, Maryland has created a separate State Department of Assessments and Taxation concerned exclusively with the property tax, while in New Jersey property taxes are the responsibility of certain bureaus in a division of taxation within a broad department of the treasury. Among other types of supervisory agencies are appointive and elective boards of equalization, branches of local government divisions, an ex officio board of assessment (North Carolina) and State comptrollers (Florida and Texas).<sup>8</sup>

There is a wide range in the legal powers of these State supervisory agencies, and experience has shown the need for adequate and clearly defined powers; but the accomplishments of the various agencies have been influenced fully as much by the size of the supporting appropriations, the quality of encouragement given by the legislature and the Governor, and the competence and energy of the personnel.

In view of the continuance of mediocre to poor assessing in wide sections of the Nation, there clearly is something wrong with the century-old system under which the States have tried to bring about competent, uniform assessment through some form of

joint administration. It may be that State supervision can never be made to work well and that complete central assessment is the only satisfactory answer.

Differences in the nature of the State agency's responsibility under the two systems are a factor to be considered. A well-trained professional assessing staff has a feeling of full responsibility for the quality of a product that it produces directly, because any defects are a clear reflection on its professional competence. When the staff's main function is supervision, however, the urge for a quality product is not quite so pressing because the product is identified with another agency. The supervisory agency may work conscientiously on valuation research, provision of aids and advice and correcting mistakes, and yet feel reluctance to go all the way in tough cracking down on local incompetence. Sooner or later it may become resigned to a policy of self-preservation by not stirring up trouble.

There are several reasons, however, why joint State-local administration need not be a futile method of trying to obtain a satisfactory quality of assessment. For one thing, many States have never tried it except in a perfunctory or half-hearted manner. The professional and financial resources devoted to this purpose have been reasonably adequate in only a few States and, more often than not, have been conspicuously inadequate. It is clear, also, that the States have been trying to regulate systems which in many instances are organized and staffed so defectively as to be unregulatable. Finally, the system is working sufficiently well in several States to indicate that, given appropriate organization, methods, and policies, it can be reasonably successful. These prerequisites are reviewed in the following chapter.

<sup>8</sup>Data on the methods of organization in numerous States are given in vol. 2. A good summary is provided in Marilyn S. Koplik, *Property Tax Assessment in the United States*, preliminary report (mimeo.), New York State Board of Equalization and Assessment, 1961, pp. 50-53.



## Chapter 10

### JOINT STATE-LOCAL PROPERTY TAX ADMINISTRATION

Most of the recent efforts to improve the quality of property assessment have concentrated on making the system of joint State-local administration work better, and a few of the States have progressed far enough to show that it can be made to produce reasonably satisfactory results. To knit this two-level system into a well-coordinated, smoothly functioning organization is a major undertaking, but it appears to be feasible if a State is willing to recognize the prerequisites and follow them with a good degree of fidelity. The resulting operation, however, will be more complicated and difficult to manage than a system of complete central assessment.

The objective, stated simply, is efficient, impartial administration of a tax that is unusually difficult to administer. It has nothing to do with tax policy and cannot afford to make much concession to tradition. Any program for this purpose, if it is to justify the effort and expense, must move uncompromisingly to produce primary assessing of all taxable property with a reasonable degree of uniformity.

No State can hope to achieve this goal unless it has a program that meets substantially the following rather obvious requirements for good administrative management:

1. A well-coordinated State-local administrative organization with a central directing authority.

This means: (a) at the State level, a single agency professionally organized and equipped for the job, with adequate powers

of supervision and regulation clearly defined by law; (b) at the local level, assessment districts so organized and staffed as to make competent local assessing feasible and the setup efficiently regulatable; and (c) sufficient integration of the two levels to facilitate good teamwork.

2. A completely professionalized assessment personnel, with compensation and opportunity for advancement adequate to attract and hold well-qualified people.

3. A workable, efficient apportionment of assessment responsibilities between the two levels, with careful coordination of assessment standards and procedures.

The setup in a few States approximates some or all of these requirements, but in a great many States the arrangements for assessment administration that would emerge from application of all three requirements would not bear much resemblance to what they now have. In some States, in fact, the departure from tradition would be almost as drastic as conversion to full central assessment.

While the issue under consideration is that of how to improve the generally prevailing two-level system for administering the property tax, the situation is complicated in some of the minority of States that have local instead of county assessing by the entry of a third layer of government—the county. While the traditional town or township government and assessment organization carried westward into the central States, the county became an important unit

of government outside of New England and in several States became an agency for assessment equalization and supervision. While this county role long tended to be rather perfunctory, and in some cases remains so to a considerable extent, the recent trend is either to make it a more active force or to shift actual assessing responsibilities to the county. The latter is by far the sounder development in administrative organization.<sup>1</sup>

### GEOGRAPHICAL ORGANIZATION OF LOCAL ASSESSMENT DISTRICTS

Most of the assessment of property for taxation in the United States is done originally by local officers operating in many thousands of local assessment districts. The geographical organization of these districts creates a more or less serious problem for many of the States. Each district should be large enough to serve as an efficient unit in a State's assessment system—a dependable local agency equipped to do a sound professional job and thus amenable to State supervision. The following minimum standards for such districts, formulated some years ago by a committee of the National Association of Assessing Officers, have lost none of their pertinence.

The political subdivision serving as an assessment district should have sufficient resources to afford adequate assessment machinery, and should provide an assessment task large enough to realize the economies of large-scale operations and to warrant the employment of one full-time assessor and at least one full-time assistant.<sup>2</sup>

<sup>1</sup> For representative versions of these developments, see, in vol. 2, Iowa, Kansas, Michigan, Nebraska, New Jersey, Pennsylvania, and South Dakota.

<sup>2</sup> National Association of Assessing Officers, *Assessment Organization and Personnel*, Chicago, 1941, p. 51.

A look at the prevailing patterns of geographic organization of local assessment districts in the individual States discloses that in a few States little reorganization would be necessary to comply with this minimum standard, that in several others the changes required would not be great, but that in a considerable number the present organization is completely untenable on a statewide basis for competent primary assessment and successful supervision.

Local assessment districts are of two types, primary and overlapping. Primary districts comprise the basic system in each of 48 States, covering the entire State areas contiguously. (Hawaii has central assessment and in Alaska property taxation is limited to the minor portion of the State's area included in municipalities and local school districts.) These districts assess for county and State purposes and also for many overlapping and underlying local governments. In 14 States the law requires or permits overlapping assessment districts, enabling some classes of local governments to do their own assessing instead of using the valuations of the primary districts and thus duplicating portions of the local assessment process.

#### *Eliminating Overlapping Districts*

The overlapping assessment districts, apparently several thousand in number, may be used optionally or may be mandatory, as in the instance of a Florida constitutional requirement that all cities and incorporated towns (subject to some exceptions) "make their own assessments for municipal purposes" although the counties comprise the primary assessment districts. Such districts represent a waste of money in their duplication of personnel and facilities, are confusing to the taxpayer, and should be abol-

ished. In Texas, for example, where there are 254 county primary assessment districts covering the State, the law authorizes or mandates to serve as overlapping districts all municipalities, some classes of school districts, and many classes of special districts, and there are upward of 1,500 such districts in actual operation. As one Texas study commission noted, "It is not unique for a property owner to be taxed by as many as seven governments, with almost as many different levels of assessment."<sup>3</sup>

In defense of the continuance of overlapping assessment districts, some municipalities cite the need for protecting themselves against deep underassessment by primary county districts when the State restrictions on local taxing and borrowing power are geared to assessed valuation, or they claim need for protection against inferior county assessment.

The first obstacle is readily removable by adoption of the device, recommended in chapter 6, of basing borrowing and taxing restrictions on State determined market value rather than assessed value. In California, where municipalities have the option of doing their own assessing as overlapping assessment districts or using the valuations determined by the county primary districts, recent adoption of a modified version of this remedy is designed to encourage use of county assessing by the small number of municipalities that have not already taken such action because of its great convenience and economy.<sup>4</sup> Competent State supervi-

sion of local assessing will remove the second obstacle.

#### *Renovating Primary District Organization*

Primary assessment districts, probably upward of 18,000 in number, are exclusively county districts in 28 states, including most of the western and southern States and a few central and eastern States. They comprise various local governments within counties in 12 States, including the New England States and Indiana, Michigan, New Jersey, New York (excluding Nassau County), North Dakota, and Wisconsin. In eight States there are various mixed arrangements, such as counties and cities, or counties in some areas and municipalities in other areas; these States are Illinois, Iowa, Minnesota, Missouri, Pennsylvania, South Carolina, South Dakota, and Virginia.<sup>5</sup>

The number of primary assessing districts in individual States ranges from 3 in Delaware to over 1,000 in each of 8 States; but the part-time township assessor is somewhat less pervasive than in former years.<sup>6</sup> The

city collected its own property taxes." (California State Board of Equalization, *Annual Report, 1960-61*, p. 17.)

<sup>3</sup> See Koplik, *op. cit.*, pp. 90-92, for a recent tabulation, by States, of the patterns of primary and overlapping local assessment districts.

<sup>4</sup> These States are Illinois, Indiana, Michigan, Minnesota, New York, North Dakota, Pennsylvania, and Wisconsin.

<sup>5</sup> When a State has a very large number of local assessment districts, the great majority of which are too small to support full-time professional appraisers and adequate equipment, the State actually is perpetuating a defective local administrative structure that does not lend itself to effective supervision. As an Indiana tax study commission recently declared, "The board of tax commissioners does not have the staff nor the funds with which to supervise assessing in 1,009 townships, and at the same time to review the budget of every unit of local government in Indiana, serve at the apex of the State's property tax appellate system, assess one-eighth of the total property tax valuation in Indiana and perform the chores associated with these responsibilities." (Indiana Commission on State Tax and Financing Policy, *Current Studies of Indiana Tax Policy, 1961*, p. 39.)

<sup>6</sup> Quoted in Texas Commission on State and Local Tax Policy, *Property Taxation and Local Revenues, 1961*, p. 3.

<sup>7</sup> Under a law enacted in 1961 "any statutory tax rate limitation to which a general-law city is subject is automatically increased, when the city transfers its assessment and collection functions to the county, in whatever proportion the assessed value of property on which city taxes were extended exceeded the assessed value of that property for county tax purposes in the last year for which the

largest recent change has occurred in the four States of Iowa, Kansas, Nebraska, and South Dakota, which together have accounted for the elimination of well over 7,000 primary districts. Some progress in this direction has been made by Illinois, Michigan, and Minnesota.

Under the "County Assessor Act" of 1947, Iowa reduced the number of its local assessment districts from around 2,500 to 120, and replaced its elective, largely part-time local assessors with appointive, full-time assessors selected on the basis of qualifying examinations. The act created the office of assessor in each of the State's 99 counties and in each city of more than 125,000 population (Des Moines only), and made it optional for other cities of 10,000 population and more to provide by ordinance for assessors. An arresting feature of the new plan, designed to lessen opposition to the change and to give all of the taxing units in each new assessment district a voice in guiding district policy, was provision for an ex officio conference board in each district with authority to appoint an examining board to screen certified applicants for the position of assessor, appoint the assessor, appoint a local board of review, determine the personnel and facility requirements of the assessor's office, set the compensation of the assessor, his staff, and the review board, and make and adopt the district's annual budgets.<sup>7</sup>

In Nebraska, assessing was done by some 2,000 precinct assessors prior to 1947, but in that year this office was abolished and the duties transferred to county assessors in the State's 93 counties. Because of the numerous counties with small populations, this did not entirely clear the way for the use of full-time assessors, and provision was made that

in counties of less than 6,500 population the people could vote to abolish the office of county assessor and combine the duties with those of some other county office. Over half of the 30 counties in this class in 1950 took advantage of this provision. Kansas formerly had over 1,600 township and municipal primary assessing districts, but in 1955 the State legislature transferred the power of assessment to county assessors. The county is now the basic unit of assessment, but the actual assessing is done largely by township and municipal deputy assessors appointed by the county assessors.<sup>8</sup>

Action by the South Dakota legislature in 1957 did not eliminate completely the township assessor system, but it provided the means by which, under the supervision of an able and energetic State Commissioner of Revenue, the quality of assessing in the State could be revolutionized. This action created a county assessor system, with each of the 64 organized counties required to have a full-time directing assessor designated as director of equalization. While the law permitted retention of local assessors, 37 counties have abolished the office entirely and a number of others have done so except for cities. Summarizing the situation in 1960, Commissioner Gillis said, "We now have 230 assessors in the State, 110 of whom are full-time career men. Before we had 1,800 assessors, only 17 of whom were full-time employees."<sup>9</sup>

*The problem of the small county district.* There are still many thousands of small primary assessment districts (and also many small overlapping districts) operating un-

<sup>7</sup> See vol. 2 for data on these changes in Kansas and Nebraska.

<sup>8</sup> Bruce D. Gillis in *Assessment Administration, 1960*, Twenty-Sixth International Conference on Assessment Administration, International Association of Assessing Officers, Chicago, 1961, p. 81.

<sup>9</sup> For more details of this plan see vol. 2, Iowa.

der part-time assessors, part-time boards of assessors, or single assessors who lack the skills and equipment to do a competent professional job. If the county were used as the organizational basis for all assessment districts the national total of districts would be reduced to a small fraction of the present number. In New York, for example, the number would be reduced from over 1,500 to 58 (treating New York City as a unit). Because of the large number of small counties in some States, however, the problems of geographic organization would still not be fully solved. Many county districts would be too small to maintain a full-time assessor, a full-time assistant, and a central office properly equipped with well maintained tax maps and other assessing tools—a minimum setup for efficient operation and supervision.

The existence of a small-county problem depends not only on size but on the complexity of a State's property tax system and the degree of heterogeneity of a county's taxable property. The minimum assessment setup assumed above would be inadequate if the range and importance of taxable personal property required an assessor trained in personal property appraisal or if a county contained complex industrial and commercial realty that could be valued only by specialists. The problem of population size alone, however, varies widely from State to State. Illustrating from the States with countywide primary districts, none of Maryland's 24 counties has a population of less than 15,000 and only 3 of Ohio's 88 counties are in this classification; but of Oregon's 36 counties, 10 range downward in population from 9,430 to 2,446; of Kentucky's 120 counties, 69 are under 15,000 population and 33 under 10,000; and if Texas could get rid of its host of overlapping districts it

would still have its 254 primary county districts, of which over 100 are under 10,000 population and 48 under 5,000.

One means of coping with the problem of the small county district when it becomes a considerable obstacle to statewide assessing efficiency is to increase the scope of central assessment to include types of real property requiring specialized appraisal and difficult types of personal property, and to provide small districts with more State technical aid than normally would be required. This may be illustrated by the program which has been evolving in Oregon.<sup>10</sup> Central assessment or appraisal has been extended to timber and large industries, and although the State has not taken over personal property assessment, the State Tax Commission is required to audit annually 25 percent of all taxable inventory accounts in each county with the cost shared equally by the State and county. The Commission makes formal agreements with individual counties to perform special services at county expense, such as keeping tax maps up-to-date when the county is too small to employ a full-time draftsman. It also makes such agreements to appraise industrial plants when the county is too small to employ a full-time industrial appraiser, with the cost divided equally up to a limit set by the legislature and borne entirely by the county above that limit.

One possible alternative is for two or more county assessment districts to employ jointly a professional assessor. This has been tried to a limited extent in Oregon, though without conclusively demonstrated success.

A more efficient and economical method of solving this problem is the creation of regional assessment districts through con-

<sup>10</sup> Details of the program are given in vol. 2.

solidation of small county districts. This procedure is familiar and widely accepted as desirable in the instance of school districts, and if the public can be given a better understanding of the technical nature and requirements of high-quality assessment administration it should be possible to develop support for the creation of territorial jurisdictions that would make such administration feasible.<sup>11</sup> For local control of a multicounty unit that would give representation to the components, a suitable device would be an expansion of Iowa's plan, noted above, for *ex officio* conference boards.

### PROFESSIONALIZING ASSESSMENT ADMINISTRATION

Local governments are accustomed to employing trained accountants, engineers, health officers, social workers, and school teachers, but they seem willing to elect as assessor any resident citizen who is old enough to vote and does not have a criminal record, and pay him less than the school janitor. Very fortunately this is not the universal procedure, but it is sufficiently widespread to explain in part why assessing is mediocre to poor in many areas.

#### *How Assessors Are Selected*

The great majority of assessors in the United States are elected to office, for terms ranging from 1 to 6 years. Two years is the most common length of term, the 1-year term being used in some instances for part-time township assessors and the 6-year period to produce overlapping terms for some boards of assessors. The various statutory qualifications for office rarely include any of a professional nature, but in Ken-

tucky no person can have his name placed on the ballot as candidate for the office of county tax commissioner (assessor), or be appointed to the office, unless he holds a certificate issued by the State Department of Revenue showing that he has been examined by it and is qualified for the office. The examination must be both written and oral.<sup>12</sup>

All primary district assessors are appointed in the States of Delaware, Georgia, North Carolina, Iowa, and Maryland, with special provisions in the last two States to assure selection of well-qualified persons. In at least 15 other States some primary district assessors are appointed, though many of the positions thus filled are not tied in with a merit system. They include a limited number of county assessors, but are mainly local assessors in municipalities with home rule charters or with statutory authorization to place the position on an appointive basis. Some assessors hold office in an *ex officio* capacity. In Ohio the elected county auditor is the county assessor, and in several States small assessment districts combine the position of assessor with other positions.<sup>13</sup>

A number of cities and large counties has been able to professionalize assessing very successfully through good personnel management and others could do so if they wished. For many of the thousands of small assessment districts some degree of professionalization has been accomplished through the work of State supervisory agencies in publishing manuals and other guides, conducting conferences and inservice training courses, often in conjunction with col-

<sup>11</sup> *Kentucky Revised Statutes*, ch. 132, sec. 380. See, also, notes on Kentucky in vol. 2.

<sup>12</sup> For a useful tabulation of data on the selection of assessors see Koplik, *op. cit.*, pp. 94-100.

<sup>13</sup> In Minnesota a law enacted in 1959 authorizes two or more units to hire an assessor jointly.

leges and universities, and providing various kinds of technical aid, and also by the assessors themselves through their State and regional associations and their top organization, the International Association of Assessing Officers. These undertakings, reviewed in the next chapter, are highly useful; but they always will carry a considerable degree of futility until the organization and staffing of all assessment districts create a true potential for professional performance.

#### *Staffing a Standard Assessment Department*

Given a statewide pattern of local assessment districts that meets the geographical standards discussed above, there are the problems of administrative organization and staffing. The assessment agency may be a department or bureau in the administrative structure of an existing government or it may be an autonomous agency of a regional assessment district. The internal organization will range from very simple in small agencies to fairly complex in large agencies. Heading the agency is the assessor. Under him, in an agency of minimal size, are at least one or two real property appraisers, a personal property appraiser and a small clerical staff. As agencies rise in the scale of size and complexity of the assessment problem, there is need not only for more appraisers but for appraisers with specialized skills. (This takes no account of the draftsmen, statisticians, computer operators, and other technical and clerical aid that the operation calls for.) Also, as agencies rise in size the chief responsibility of the assessor shifts from property appraisal to administration, in which he must have competence fortified by a broad understanding of the assessment function.

Regardless of the size of the agency, the assessor and his appraisal staff must be professionally qualified for their responsibilities. To assure such qualification on a statewide basis the following principles and procedures are proposed.<sup>14</sup>

1. *All taxable property in the State should be appraised for taxation only by appraisers certified as to qualifications on the basis of examination by a public agency authorized to perform this function.*

The equitable appraisal of property for taxation requires professional training and skill. For the practice of this profession there should be qualifying training and certification, as there are for other professions, for the protection of the public. Iowa requires qualifying examinations for all assessors and deputy assessors. Oregon enacted a law in 1955 providing that only certified appraisers may appraise real property, and Kentucky, as previously noted, requires certification by the State Department of Revenue before a person can become a candidate for the elective office of county assessor.

2. *All assessors should be appointed to office, but with eligibility for appointment based on State certification as to qualifications.*

Appointment of the assessor does not assure competent performance any more than it does for other key administrative positions, and there are many capable elective assessors; but when appointment is limited to persons with certified professional qualifications there is more assurance of employing a person with the required technical and

<sup>14</sup> Most of these proposals have had strong sponsorship in the past, very notably some years ago by a Committee on Assessment Organization and Personnel of the National Association of Assessing Officers. (See *Assessment Organization and Personnel*, *op. cit.*, pp. 153-199.)

administrative skills than if the decision is left to the voters. Popular election is not the best way to choose an officer to fill a technical administrative position. Some elected assessors acquire skill in office, build up professional reputations, and succeed in being reelected for term after term; but running for reelection steals time from the work of assessing, and when the turnover in office is frequent a community is likely to experience a succession of incumbents each learning his job at public expense.

The appointive assessor, although he does not have to run for election, may be no less subject than the elective assessor to pressure group opposition to equitable assessing. Thus his success must depend in part on the backing of alert State supervision and on the support of the people through their election to office of policymaking officials who want uniformity of assessment.

*3. There should be no requirement of prior residence in the assessment district for appointment to the office of assessor.*

The appointing authorities must be as free to search widely for a suitable person as they would be in employing a school superintendent or a city manager. The requirement of local residence severely limits the choice of possible candidates, may preclude any suitable choice, and is a serious handicap to development of the profession of assessor by preventing advancement from one district to larger and better positions in other districts. In setting up a plan for requiring the appointment of certified assessors and providing for their certification that was in most respects admirable, Iowa made the one fatal mistake of including a district residence requirement. Particularly because of the State's numerous small county assessment

districts, it has not been feasible to set as high standards or create as attractive promotional incentives as would have been possible without this restriction.

*4. Assessors should be appointed by the chief executives or executive boards of local governments when assessment districts are coextensive with such governments, and by the legally constituted governing agencies of multicounty districts.*

In Maryland, which has come closer to centralizing assessing than any State except Hawaii, the director of the State Department of Assessments and Taxation appoints the county Supervisors of Assessment from lists of five nominees, usually persons who have come up through the ranks, submitted by the county executive authorities. In this compact State, with its 23 counties and one independent city, a total of 24 assessment supervisors, and well-coordinated assessment administration, this plan of State appointment appears to work well. The possible desirability of a policy of State appointment is worth consideration by other States; but local executive appointment, restricted to State certified candidates, has some special advantages. It represents less departure from local tradition, puts more pressure on the local administration to support the assessor's work, and provides a better chance of obtaining an officer who will fit harmoniously into the local administrative organization. The State supervisory agency should be equipped to encourage consultation on local appointments and to give sound advice.

Assessors should be appointed for indefinite, rather than fixed, terms and should be subject to removal for good cause, including incompetence, by the appointing authori-



ties.<sup>15</sup> They should have the protection, however, of being entitled to a clear statement of the grounds for removal and, upon request, a public hearing.

5. *The State agency authorized to supervise property tax administration should be empowered to establish the professional qualifications of assessors and appraisers and certify candidates as to their fitness for employment on the basis of examinations given by it or of examinations satisfactory to it given by a State or local personnel agency.*

No person would be permitted to hold the office of assessor or to appraise property for taxation who was not thus certified, and the State agency should be empowered to revoke certification for good and sufficient cause.<sup>16</sup>

This arrangement, without interfering with the efficient functioning of established local personnel departments and merit systems in large assessment districts, would set uniform statewide standards for assessors and all classes of appraisers and provide statewide opportunity for professional employment and advancement at both State and local levels for qualified personnel.

6. *The State supervisory agency should be empowered to prescribe and enforce minimum professional staffing requirements in all local assessment districts, and also to contract with local districts for the provision of part-time technical personnel.*

These provisions are highly important, since a good-quality assessment operation requires not only professional personnel but adequate personnel for the job, in both

number and kinds of appraisers. The appraisal of personal property, for example, calls for skills that are different from those needed for the appraisal of real property, and complex types of real property demand the attention of specialized appraisal engineers. The policymaking officials in many local assessment districts may not be well informed as to the requirements or may be influenced by false concepts of economy.

In Oregon, where assessing is on a county-wide basis but a number of the counties are small in population, the legislature has undertaken to meet the minimum personnel problem by requiring each county to provide the assessor with the full-time services of one certified appraiser for each \$30 million or fraction thereof of the true cash value of locally assessed property, and by authorizing the State Tax Commission to enter into formal agreements with counties to provide part-time technical and industrial appraisal services when the work does not justify full-time local employment.

7. *To avoid obstruction to the local recruitment and retention of competent professional personnel, the State legislatures should not set, or place limits on, salaries paid certified local assessors and appraisers.*<sup>17</sup>

Professionalizing the assessing function means more than making positions appointive and requiring qualifying examinations and certification. The work itself is sufficiently challenging to interest persons of ability; but to be able to recruit and hold such people it must be made professionally attractive by paying assessors and appraisers as much as they would receive in other pub-

<sup>15</sup> Some opinion favors fixed terms. Iowa prescribes 6-year terms for its appointive assessors but permits their removal by the conference boards that appoint them for "misconduct, nonfeasance, malfeasance, or misfeasance," subject to a public hearing if requested by the assessor.

<sup>16</sup> See vol. 2 for methods of State certification of assessors and deputy appraisers in Iowa and Maryland, and of real property appraisers in Oregon.

<sup>17</sup> A few States make constructive use of minimum figures. In Oregon, for example, the salaries paid certified assessors and appraisers shall not be less than those applicable to State appraisal personnel of similar classification.

lic and private business for work requiring similar amounts of training and competence, and by providing clear opportunity for advancement in compensation and responsibility. The inevitable alternative is the downgrading of qualifications to admit mediocre types for whom the available jobs still have appeal, and a constant turnover in employment that is extremely wasteful.<sup>28</sup>

### THE STATE SUPERVISORY AGENCY

The State supervisory agency is the key to achieving statewide coordination of assessment administration at a high-quality level and a sufficient integration of policy and procedure to make the property tax serve statewide as one clearly defined major tax instead of variegated local versions of a tax.

As has been emphasized in the discussion of local assessment district organization and staffing, the State level component of this joint administrative operation has to function with a large amount of futility and waste motion unless its local relationships are with a reasonably efficient local organi-

zational setup and with assessors well trained for their jobs. Even under less than satisfactory local conditions a well-constituted State supervisory agency can accomplish enough to justify its continued strong support; but there should be no illusions about its ability to produce equitable assessing on a statewide basis without correction of local weaknesses in the overall administrative structure.

Thoroughly professionalized local assessment administration, well supervised by a central State agency, helps areas that already have scientific assessment as well as those areas that are enjoying this advantage for the first time. For the trained assessor heading a large, efficiently administered local assessment district, this is not just a boon to the bucolic hinterland but an aid to his own work that calls for his strong support. Statewide professionalization of property appraisal helps to solve his recruiting problem, statewide maintenance of sound assessment standards eases his job of forthright enforcement of assessment law, and the State-local relationship becomes a truly professional one, dealing with technical problems of mutual concern.

### *Functions of the State Agency*

Before considering the place of this agency in the State's administrative structure, some note should be taken of the administrative functions that belong in the agency's jurisdiction and determine the agency's character and importance.

First, there is the broad and vital function of supervision of local assessment administration. Supervision is an inadequately descriptive term for this function because it ranges from giving advice, interpreting the tax law, issuing rules and regulations, and providing various profes-

<sup>28</sup> What constitutes an adequate scale of salaries is bound to vary considerably in different sections of the country. For purposes of illustration, two actual schedules are summarized here for States that rank relatively high in the quality of assessing, one for local and the other for State personnel. In Maryland, the legislature establishes a scale of annual salaries for local assessors for which the State will provide 60 percent reimbursement; it places no restrictions on payment of higher salaries but makes no reimbursement for the excess. The figures for 1963 are (in part): assessors' aids (internships), \$4,302-\$4,610; assessors, \$4,790-\$5,990; senior assessors, \$5,350-\$6,688; assistant supervisors (large counties), \$8,323-\$9,276; supervisors (chief assessors), smallest counties, \$5,970-\$7,464, largest counties, \$9,320-\$12,745. In California, the 1962 scale for State personnel (converted from reported monthly salaries) was (in part): junior property appraiser, \$5,280-\$6,120; assistant real property appraiser, \$6,744-\$8,196; associate real property appraiser, \$8,196-\$9,948; senior real property appraiser, \$9,852-\$12,096; principal property appraiser, \$11,520-\$13,992.

sional and technical services, through checking assessment performance by statistical studies and field investigation, enforcing assessment standards, and even suspending or removing assessors from office. Some of these features are considered in the following chapter.

Second, in 40 States some property subject to local general property taxation is State assessed. Most commonly this includes the operating property of railroads and other public utilities, discussed in chapter 13, but in a dozen States one or another of several other types of property are centrally assessed.<sup>19</sup> An extension of this policy could solve a number of perplexing assessment problems.

Equalization, a third function, has to do primarily with ironing out or compensating for differences in assessment level among a State's local assessment districts; but in a broad sense it concerns, also, obtaining uniformity of assessment among classes of property, including State assessed and locally assessed property.

Valuation research, concerned with developing better assessment standards, methods and tools, is an indispensable fourth function that reinforces the foregoing functions.

The conduct of these four related functions should be the work of one well-integrated agency responsible for the State's

share of property tax administration. What relation this agency might have to the quasi-judicial function of hearing assessment appeals that is now handled by State review or appeal boards in many States is considered in chapter 12.

State supervision of assessment administration is, to be sure, only one of several features of State supervision of property tax administration; but it is by far the most complex and difficult feature and needs the integration and emphasis that are indicated here. The billing and collection of taxes and enforcement of tax liens, although they involve different techniques, are related features whose supervision falls properly within the jurisdiction of this agency.

#### *Place in the State Administrative Structure*

This agency should rank sufficiently high in the echelons of State administration to mark its key position in the administration of what is the largest single source of tax revenue in many States. It needs more "status" than any single local organization for assessment administration in the State. The agency should be headed by a career administrator of recognized professional ability and knowledge of the property tax and its administration, who, in a State that has professionalized its system of assessment administration, may have moved upward through that system.

The function of this agency is revenue administration; therefore the agency should be identified with the State's organization for revenue administration. If a State's tax administration is coordinated in a central tax department, the agency should be a major division in that department. This has such notable advantages as supervision and support by a high-ranking, influential department head responsible for the effi-

<sup>19</sup> These include mainly: mining property or the proceeds of mines in Arizona, New Mexico, Montana, Nevada, Utah, and Wyoming; textile and other manufacturing property in South Carolina; distilled spirits in Kentucky and Maryland; oil and gas contractors' equipment in New Mexico; tangible personalty of corporations in Maryland; tangible personalty used in business in Ohio (a joint State-local operation); capital stock of certain domestic corporations in Illinois; bank stock in Nevada and New Mexico.

For details for 1961 see U.S. Bureau of the Census, *Assessed Values for Property Taxation*, Preliminary Report No. 5, 1962 Census of Governments, 1962, table 1.

cient overall functioning of the department; the convenience and economy deriving from access to such general facilities of the department as legal, research, and clerical services and data processing equipment; and organizational recognition that the property tax is an integral part of the State's tax structure. If a State's organization for tax administration is diffused, the property tax agency should be given due prominence as a separate department or bureau.

Given this type of organizational setup, professionally staffed and directed, its long-range success will be very dependent on the support it receives from the Governor and the legislature.<sup>29</sup> Unless the Governor appoints highly capable directors of revenue or tax commissioners who appreciate the significance of the agency's responsibilities, and unless the legislature, through its tax committees and research facilities, keeps an eye on the agency's performance and needs, the effort to produce effective joint State-local assessment administration is likely to prove disappointing.

#### *Boards of Review*

In the foregoing summary of structure for effective joint State-local assessment administration, there has been no reference to the hierarchy of boards of review, boards of tax appeals, and boards of equalization which in most States comprise part of the administrative paraphernalia for performing the

<sup>29</sup> This assumes that the Governor has strong executive powers, including the power to appoint top tax administrators.

assessment function. Dependence is placed on a simple, well-coordinated administrative organization to provide complete, uniform assessment, namely, on a system of local-level assessment districts, well organized geographically and staffed professionally to produce the required product, and a State level supervisory agency, well staffed with technicians, to provide production rules, aid and guidance in production, inspection of the work, advice on how to improve it, and authority to require adjustment when necessary.

There is no place in this organization for boards of part-time inspectors participating in the supervisory process, which is what these administrative boards are when they act on their own motion to correct mistakes and make adjustments in behalf of uniformity through so-called "review" and "equalization." For this purpose these agencies are redundant, complicate the State agency's supervisory duties, diffuse responsibility, and contribute nothing in the way of superior knowledge and skill. The State agency should perform this function directly as part of a continuous process of supervision.

When these review and appeal boards act in a quasi-judicial capacity to hear taxpayer complaints, they serve the essential function of recognizing the taxpayers' right to a hearing under due process of law. Whether they provide the taxpayer with the protection that he needs, or there are better means of accomplishing this purpose, are matters which are considered in chapter 12.

## Chapter 11

### CENTRAL ASSESSMENT SUPERVISION AND SERVICES

The last chapter considered the position of a central supervisory agency in a well-organized system of joint State-local assessment administration and identified the agency's four basic functions related to assessing—(1) supervision, (2) central assessment, (3) equalization, and (4) research. This chapter deals with the nature of these responsibilities, more particularly with the broadly inclusive features of supervision of local assessment administration.

Even if a State has a geographically efficient local assessment district organization, with each district adequately staffed with professional personnel, the key to uniformity of assessment on a statewide basis is a capable central supervisory agency with all appropriate powers and facilities. Just as in the instance of any private business corporation with decentralized operations, there must be skillful coordination to obtain uniformly good results. In most States these underlying organizational and professional prerequisites are either lacking or only partially developed; but regardless of prevailing conditions each State needs a strong central agency that will do the best it can administratively with what it has to work with, and also will be able to plan ways and means of improving the existing setup and advise with the legislative and executive authorities in securing their adoption.

Most of the States, as previously noted, have a State agency or designated State official responsible for at least some degree of supervision of local assessment administration, and in many States the statutory powers of supervision are rather demanding and

extensive. A reading of the statutes, however, gives little clue to the scope and effectiveness of the actual supervisory operations in the various States. There are State agencies that have comprehensive statutory powers and use them well, State agencies whose reluctance to engage in energetic supervision is bolstered by the ambiguity of their legal powers, State agencies whose competence and prestige give them strong influence despite their limited legal authority, and State agencies whose powers are broad but their performance perfunctory.<sup>1</sup> In many cases the failure of the State regulatory agencies to use the powers at their disposal stems largely from the failure of the legislature to make adequate appropriations.

There is more pertinence, therefore, in discussing the essentials of central supervision and the means which the States are employing to meet them than in enumerating the legal powers of the various State agencies. A review of these essentials will indicate the scope and nature of the legal powers which the supervisory agencies should have, the functions which they should be required specifically to perform, and the means of enforcement which should be at their disposal.

<sup>1</sup> Some supervisory powers have lain dormant so long that any effort to use them arouses great hostility. When, for example, Prof. Haden became Alabama Commissioner of Revenue in 1959 he said that of the 45 taxes administered through his department the property tax was being administered further from the law than any other tax. When he tried to use his statutory authority to enforce the law the legislature threatened to repeal his enforcement powers. (See Robert H. Aland, "Ad Valorem Property Taxation: Equalization by Injunction," in *Alabama Law Review*, vol. XIV, No. 2 (Spring 1962), p. 401.)

## SUPERVISION OF ASSESSMENT ADMINISTRATION

Doing a competent, comprehensive job of central supervision of local assessing is one of the most intricate and demanding undertakings in State administration. The central staff necessarily includes various appraisal and statistical specialists and, since the central agency serves to complement a widely decentralized assessing operation, work in the central office needs supplementing by extensive field work and contacts with local assessors. The function calls for continuity of action rather than spasmodic efforts, and it costs much more to perform it well than most States have been willing to spend. The relationship between the central agency and the local agencies needs to emphasize professional cooperation to produce uniform primary assessing, rather than *ex post facto* action to compensate for bungling assessing efforts. Quite obviously the operation can be less expensive and more successful if it does not have to cope with unwieldy local organization and unskilled local personnel.

The multifold supervisory activities of a well-qualified central agency may be classified as: (1) factfinding and analysis, (2) provision of assessment tools and equipment, (3) provision of professional and technical services, (4) assessor training and orientation, and (5) enforcement of standards.

### *Factfinding and Analysis*

Assessment supervision requires systematic factfinding as a basis for intelligent operations. No assessment problems can be solved unless the central agency knows what the problems are and where they are. This function involves careful field inspection, with opportunity to discuss problems with individual local assessors; but in support of

the entire supervisory operation there must be a steady inflow and analysis of basic statistical data.

The central agency should be empowered to require assessors and other local tax officers to report such data in such form and content as it prescribes, and it should make certain that the reporting is sufficiently classified and detailed to provide the information it needs for adequate supervision and study. For example, the supervisory agency is seriously handicapped, the assessors cannot function competently, and the public is inadequately informed, if the local assessment records cannot produce readily a meaningful breakdown of assessed valuations by classes of property. When such information has to be accumulated periodically through laborious research projects, instead of flowing readily from uniformly and properly designed local record systems, supervision operates under a chronic handicap.<sup>2</sup>

*Measuring the quality of assessing.* As discussed in chapter 5, State supervisory agencies now have readily at their disposal the means for continuous and systematic evaluation of the quality of assessing in each local assessment district.<sup>3</sup> The develop-

<sup>2</sup> The North Carolina Department of Tax Research emphasized this point in its excellent biennial report of 1960 when it explained that: "The assessment data included here were tabulated from the county annual reports . . . Many counties fail to supply much valuable information, and for this reason some of the tables are incomplete . . . An attempt was made to show separately residential, commercial, and industrial real property for each county . . . Some counties reported the classes of property accurately, but most counties did not separate the above classes of property. By checking the town reports, the township reports, and the returns for the utility companies, plus the industrial directory, it was possible to get some reasonable estimates on the types of property for the counties that omitted some of the details in their county reports. It is the first time the data have been checked so carefully on classes of property." (State of North Carolina, *Statistics of Taxation*, 1960, p. 306.)

<sup>3</sup> See pp. 48-50.

ment of scientific sampling and data processing has facilitated assessment ratio studies to determine the average level of assessment, the degree of uniformity with which each major class and subclass of real and personal property is assessed, and the degree of assessment uniformity that exists among the several classes. Such studies, as previously noted, are in widespread use to determine average levels of assessment, but their potential for measuring and improving assessment quality remains undeveloped in the great majority of States.

By means of this indispensable supervisory tool weak spots can be identified for study and correction, progress can be measured, and taxpayers can be kept reliably informed of how equitably, or inequitably, they are treated. The value of this tool depends, it must be emphasized, on careful adherence to sound statistical procedures; but useful qualitative data on the assessment of major classes of real property can be developed by relatively simple methods. Refinements and expanded coverage can be undertaken from time to time as dictated by experience and need.<sup>4</sup>

This qualitative assessment ratio analysis provides the central agency with valuable information, but it must influence the work of the local assessors in order to achieve its purpose of improving assessing. In Oregon, as has been noted, every local assessor is required by law to make an annual assessment ratio study in accordance with the State supervisory agency's specifications, and local findings are checked by that agency's own studies. In South Dakota,

<sup>4</sup> As noted earlier, these sampling studies may be based on verified, bona fide sales, on sales supplemented by independent appraisals when actual sales are not sufficiently representative of certain classes of property, or entirely on independent appraisals.

where the central agency has made real estate assessment-sales ratio studies annually since 1958 and published the findings, with medians, frequency distributions, and indexes of inequality, by counties, for urban and rural property, State Commissioner of Revenue Bruce D. Gillis has stated that when the assessor has a part in the collection of the data and the analysis "he will also be more inclined to do something about the inequities."<sup>5</sup> Commissioner Gillis has observed, respecting the effect of these studies:<sup>6</sup>

Inservice training has made the ratio study a practical tool which the assessor would not release. He no longer regards it as a theory which might have merit for deliberations of equalization boards without possessing any practical utility. The boards, for their part, now realize to a greater extent how important it is that assessors understand and believe in the concept of equalization and the mutual use of ratio study. It is comforting for us to note how the upgrading of assessors and boards becomes a concurrent phenomenon.

For competent local assessors with adequate resources, assessment ratio analysis is a familiar statistical tool;<sup>7</sup> but most State

<sup>5</sup> State of South Dakota, Department of Revenue, Division of Taxation, *Fourth Annual Report of the Real Estate Assessment Sales Ratio Study*, 1961, p. 2.

<sup>6</sup> Bruce D. Gillis, in International Association of Assessing Officers, *Assessment Administration, 1960*, op. cit., p. 82.

<sup>7</sup> For example, in a discussion of how to maintain the uniform assessment of real property, following a comprehensive revaluation, without a complete annual reappraisal, Richard A. Chandler, assessor of real property in Richmond, Va., cites as his dependable statistical aids a pin sales map, analysis of rental changes, maintenance of index cards and sales book covering every sale each year, in which "inequitable assessments stick out like sore thumbs," and annual computation from sales data of an index of assessment inequality. On the pin sales map (a device initiated in Arlington County, Va.), each year there is placed a colored pin for each sale of real property, with the color different for each 10 points difference in assessment-sales ratio. "From this map appraisers can spot points that appear to need immediate attention." (R. A. Chandler, "Market Value and Equity Every Year," in *Assessment Administration, 1960*, op. cit., pp. 63-71.)

agencies still have to deal with many assessors who must be trained and assisted in the use of such techniques. Even with the statewide development of efficient local assessment district organization and personnel, the scientific conduct and analysis of assessment ratio studies on a statewide basis will continue to be needed for the advancement of uniform primary assessment. To repeat a previous recommendation, State supervisory agencies should be adequately financed and staffed for this purpose and be required to conduct such studies annually and publish the findings as to average level and degree of uniformity of assessment in all assessment districts.

For purposes of ready evaluation and comparison of results, establishment of minimum assessment standards, and informing the public, a simple index of assessment inequality is needed to reflect the findings of assessment ratio studies. Serving well as such an index is the coefficient of dispersion used by the U.S. Census Bureau in evaluating the findings of its assessment-sales ratio studies and by numerous State and local assessing experts. This measures, for the class of property under consideration, the extent of deviation of individual assessment ratios from the median ratio for the area. The procedure may be shown by the following simple illustration in which the sample comprises seven parcels of real property. In this illustration the index of inequality is found to be 15, which discloses relatively high-quality assessing.

The lower the index the more uniform are the assessments. How low the index should be to indicate good quality assessment must be determined by actual performance in assessment districts known to be well-organized, staffed and equipped and by the

Sales price	Assessed value	Assessment ratio (percent)	Deviation from median
\$30,000	\$9,300	31	9
20,000	7,200	36	4
22,000	8,360	38	2
18,000	7,200	40	0
15,000	6,900	46	6
9,000	4,230	47	7
10,000	5,400	54	14

42

Median assessment ratio, 40. Average deviation,  $42 - 7 = 6$ . Coefficient of dispersion,  $6 \div 40 = 15$  percent (Index of inequality).

opinions of assessment experts. Since neither sales nor appraisals can be perfect measures of market value there will always be some dispersion; but there is considerable support for the view that an index of 20 marks acceptable and attainable assessing and some opinion that with today's approved techniques an assessor should be able to achieve an index of 15 or better. There is little disagreement that an index as high as 30 is so indicative of inequitable assessment as to call for drastic reform in assessment administration.<sup>8</sup> The Census Bureau's 1961 ratio study found some improvement: out of 1356 selected areas (all but about 100 the same as those surveyed in 1956), the index was 20 or better in almost one-third of the districts and was in excess of 30 in slightly less than two-fifths of the districts. (U.S. Bureau of the Census, *Taxable Property Values, 1962 Census of Governments*, vol. II, 1963.)

#### *Provision of Tools and Equipment*

There are certain basic tools and facilities which a local assessor must have to be efficiently in business. State supervision is a futile procedure unless it sees to it that this equipment is provided and maintained. Part of it only the State supervisory agency

<sup>8</sup> The Census Bureau, in its nationwide assessment-sales ratio study covering 1,263 selected local assessment districts in 1956, found that the index for single-family houses was 20 or better in only one-fifth of the districts, and was in excess of 30 in nearly one-half of the districts.



can supply satisfactorily and therefore should be required to do so; part of it the State agency should be empowered to require the local governments to provide. If a local assessment district lacks the resources to furnish the necessary facilities and an assessor competent to use them, there is clear evidence that the district has no good excuse for existence.

*Tax maps and record systems.* One of the serious deficiencies in local assessing tools disclosed by the numerous State supervised revaluation programs initiated in recent years has been the widespread lack of accurate tax maps and orderly, informative record systems.<sup>9</sup> A tax map is a large-scale map divided into sections for convenient use, which delineates all of the owned parcels of land in an assessment district and shows their dimensions and areas, along with such other pertinent data as may be desired. Applied to it is a parcel numbering or index system to simplify parcel descriptions and reference to them. Refinements in the use of aerial surveys have facilitated and reduced the expense of developing accurate maps. Maps must be kept up-to-date to reflect changes through subdivision or other causes. Through his set of tax maps the assessor can make sure that he has all the real property in his district on the assessment roll and is able to identify clearly the location, size and shape of all the parcels he must

<sup>9</sup> In very many local assessing districts the deficiencies are of an even more rudimentary nature, including lack of office space, steel files, typewriters, and adding machines. A revealing survey in one State describes the resources and equipment of "the average assessor in the average county" as follows:

"The 'average' county assessor receives a salary of \$2,400 a year out of which he must defray any travel expense incurred and pay for any clerical assistance received . . . He has no office or field help. . . . The assessor has a single small room assigned to him in the courthouse. This room is usually provided with a table or desk and one or two shelves for field books but no other equipment. He

appraise.<sup>10</sup> Such maps, moreover, have proved to be widely useful for other agencies of government, including planning and public works, and for private business interests.

At least a dozen States have recently completed or are currently engaged in State sponsored mapping programs, some of them in conjunction with revaluation programs, designed to equip all local assessment districts with tax maps, and several other States provide technical aid for local projects. Unless a district is large enough to justify development of its own staff for the job, it must employ outside professional service or obtain technical aid from the State. Maryland's recently completed statewide mapping program was conducted, at State expense, by a mapping section of the State supervisory agency. West Virginia is expediting statewide revaluation, including mapping, by contracting directly with private firms to do the work under State supervision and meeting 90 percent of the expense. In Oregon, the central agency's mapping section is approaching completion of a mapping project as part of a coopera-

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may share a typewriter or adding machine with some other official. The only record maintained is an alphabetically arranged roll for each civil district and each municipality, usually referred to as 'field books'. Entries are in long-hand, very often in pencil. Property identification is by 'bounds'.

"Of the 6 months which this 'average' assessor devotes to his official duties, about half is spent in fieldwork. The process of establishing values is entirely subjective; there is no pretense that assessed valuations have any particular relationship to current market values. Once the value of a property is established it is apt to remain fixed for a generation, regardless of changes in assessing personnel or changes in the real estate market." (Cecil Morgan, *Property Assessment Administration in Tennessee, 1955-56*, Report to the County Tax Assessment Subcommittee of the Legislative Council Committee, 1956 (p. 19.)

<sup>10</sup> For a step-by-step description of the preparation of tax maps see E. D. Ballard, Kentucky Department of Revenue, "Preparation of Tax Maps," in International Association of Assessing Officers, *Assessment Administration, 1960, op. cit.*, pp. 136-150.

tive State-county revaluation program, the cost of which is shared equally. Utah has assured standard tax maps for all counties by making State fiscal aid for this purpose contingent on State approval of local mapping programs. New Jersey is advancing a mandatory program under which, if a local unit does not install maps within a specified time, the State provides them at the local unit's expense. California's supervisory agency conducts a contract mapping program. Among other States providing various forms of technical and financial aid for mapping are Colorado, Kentucky, Virginia, and Washington.

According to a recent study, the assessment laws of 32 States authorize or require the preparation and use of tax maps, 33 States report that some or all primary assessing districts have tax maps, and 8 States report that all primary districts are thus equipped.<sup>11</sup> In some States where tax maps are mandatory, however, the requirement is not enforced, and in two or three of the States that report statewide coverage some of the mapping fails to meet minimum standards.<sup>12</sup>

In view of the basic importance of this assessing tool, every State should require the acquisition and maintenance of tax maps meeting specified standards by all local assessment districts and make it a duty of the State supervisory agency either to install standard maps or to approve mapping plans and supervise map production, and, following completion, to assure that all maps are kept current.

<sup>11</sup> Marilyn S. Koplik, *Property Tax Assessment in the United States*, *op. cit.*, pp. 57-67.

<sup>12</sup> In Louisiana, for example, a check of 58 parishes in 1960 disclosed that the tax maps in fewer than one-third met or came close to meeting adequate standards. (Public Affairs Research Council of Louisiana, Inc., *Louisiana Property Tax*, vol. 1, Baton Rouge, 1960, p. 49.)

Without a well-devised record system the assessor is almost certain to do a blundering, incompetent job. Such a system dictates the kinds of information that must be uniformly available for accurate property appraisal and production of the assessment roll, and provides for the orderly classification and filing of data in such manner as to make them readily and conveniently available for all necessary uses. For example, in the assessment of real property a basic requirement is an appraisal card for each parcel, filed geographically to facilitate checking with tax maps, which contains virtually all the recordable information necessary for appraisal of the property. Among the supplements to this file would be an ownership record file, the names, with addresses, listed alphabetically and cross-referenced to the appraisal card file. Antiquated types of assessment roll books need to be replaced by the most efficient system that the volume of work facilitates and justifies. The assessment of personal property calls for the use of well-devised personal property reporting forms, calling for cost data rather than nebulous "value" data, and for suitable recording and filing arrangements. The character and scope of the record system will be influenced by such features as the size and nature of the district, the classes of property taxed, and the degree of mechanization that is feasible in data processing, but the basic requirements are applicable to all districts.

The development of standard record systems is facilitated by State prescription or approval of well-devised assessment and tax forms for local use.<sup>13</sup> One of the very use-

<sup>13</sup> The great majority of States have some kind of form-prescription requirement. According to the Koplik study (*op. cit.*, p. 56), 21 States prescribe certain forms and 19 States furnish as well as prescribe forms.

ful functions that a State supervisory agency should be required to perform is that of devising, prescribing, supplying, and requiring the use of basic types of forms. The legal authorization needs to be in broad terms rather than detailed specifications, however, to avoid a freezing in of procedures that may become obsolete. State-wide uniformity in prescribed forms has advantages that make it desirable to the extent that it is efficiently applicable; but the State agency needs flexibility to approve alternative arrangements that more satisfactorily serve the needs of any district or group of districts.

*Data processing facilities.* The extent to which an assessment district can mechanize its operations by installing data processing equipment is dependent on its size, with electronic computers within reach of only the largest districts; but it should be feasible for many districts to enjoy the advantages of automation in the processing of assessment rolls, tax rolls and tax bills through the joint use of equipment or the use of privately operated service bureaus. An increasing number of districts are using service center facilities, and at least one intercounty group of assessors and treasurers, in the State of Washington, has been working on a plan for cooperative electronic data processing;<sup>24</sup> but few State supervisory agencies have taken the initiative in exploring the merits of these procedures and the ways and means of making joint use of equipment available, such as rental of a State's own installed system.<sup>25</sup>

<sup>24</sup> See Richard C. Watts, "A Plan for Consolidated Electronic Data Processing," in International Association of Assessing Officers, *Assessment Administration, 1960*, op. cit., pp. 43-45.

<sup>25</sup> The Oregon State Tax Commission recently began exploring actively the feasibility and costs of alternative data processing procedures as a basis for possible recommendation of a standardized electronic or machine record system for counties throughout the State. One county has data

The States clearly have a responsibility for safeguarding and guiding this development.

*Manuals and guides.* In carrying out its responsibility to produce uniformity in assessment administration in accordance with carefully determined standards, a State supervisory agency is under the necessity of preparing and issuing manuals and other publications for the guidance of local assessors. The publications issued variously by State agencies are of five general classes: (1) handbooks of laws, rules and regulations, (2) appraisal manuals, (3) special manuals and studies, (4) cost and price schedules, and (5) news and reference bulletins. The central agencies in a majority of the States issue some kind of publication designed to aid local assessors; but not many of them, desirable as it may be, produce all of the five types noted.

Of very practical importance is an assessors' handbook, revised or supplemented after each legislative session, containing rules, regulations, and interpretations related to each provision of the property tax and assessment laws. Appraisal manuals are technical textbooks giving standard methods and procedures for appraising the various classes of property. Separate manuals may be issued for the appraisal of urban realty, rural realty, and personal property. Manuals require frequent supplements to reflect such changing factors as unit construction costs and also need periodic revision. These manuals are useful for training appraisers as well as for statewide coordination of the work of assess-

processing machinery, two counties are trying the use of service center equipment, and by agreement with another county the Commission has made a test installation, at its expense, of data processing card procedure for appraisal records and county assessment and tax rolls, involving cooperative use of machines now used by the Commission in processing income tax records.

sors. Standard appraisal manuals, with supplemental services, are available from private sources, and some States designate a specific manual or system for statewide use; but numerous State supervisors prefer to develop their own manuals in order to have them conform to the particular property and tax conditions in the State and to the particular needs and capabilities of the local assessors. In some instances an outside appraisal firm is retained to prepare a manual, an arrangement that should have the close collaboration of the State agency's own staff. A State prepared manual tends to receive better understanding and acceptance when there has been consultation in its preparation with outstanding local assessors.

Special problems of assessment administration, such as the appraisal of difficult types of property, handling property exemptions, office organization, and the like, call for special studies and reports from time to time when the issue is one of widespread concern to local assessors. To illustrate, California's supervisory agency, which is a leader in this type of service, in fiscal 1959-60 issued, reissued, or prepared for issuance 14 different manuals or special reports on such diverse topics as "Appraisal of Industrial Plants," "Assessors' Office Management and Organization," "Timber Appraisal Manual," and "Duties of Assessor at Equalization Hearings." As a further means of securing statewide uniformity in appraisal, some State agencies compile and publish cost data schedules annually, such as unit cost data on various types of construction, prices of new machinery and equipment and other classes of personalty, and market data for livestock. Finally, in order to keep assessors currently informed about new developments of professional interest, useful new books and articles, avail-

ability of new assessing tools, and the like, several State tax departments or supervisory agencies publish monthly bulletins or newsletters.

#### *Professional and Technical Services*

The professional and technical services to local assessors that can be provided by a well-equipped central agency can go far in statewide standardization of assessing if the central agency has efficiently constituted local organizations to work with, and can offset some of the incapacity of less well-constituted local organizations. These services range from answering inquiries and giving general assistance and advice to helping with difficult assessment problems, their general character pointing up the kinds of powers, policies, and facilities that are needed.

In line with the authority possessed by most supervisory agencies to advise and instruct assessors respecting their duties, the most obvious forms of service include such things as answering oral and written inquiries, conferring on problems, issuing instructions and guides of the types noted above, and preparing approved lists of reappraisal and mapping consultants. Many inquiries involve interpretation of the tax law. A few State agencies are authorized to construe the law, but ordinarily some member of the agency staff or legal section of the tax department advises on questions covered by authoritative opinion, and unusual questions are referred to the attorney general.<sup>18</sup> Supervisory agencies in about one-half of the States hold annual confer-

<sup>18</sup> To pass on serious problems, Kentucky has a property tax policy committee of five members, including the Commissioner of Revenue, an assistant attorney general, the director of the research staff of the Department of Revenue, the director of the property tax division, and the director's first deputy.

ences of assessors to discuss problems and in a few States conduct regional meetings.

Competent supervision of local assessment, however, cannot be maintained solely from the central office, even with the aid of periodic conferences. The central agency needs to know, first hand, the conditions in each local assessment district that have been pointed up in a general way by its assessment ratio studies, and the particular opportunities for providing aid, while many assessors need on-the-spot advice on such matters as office organization and equipment, personnel problems, and special problems of assessment. Thus one of the essentials for a central agency is an adequate and capable field staff, including experienced assessors who have a broad knowledge of assessment administration as well as ability to instruct and win confidence. In States of any considerable area, the use of district offices has the advantage of placing consultation centers within more easy reach of assessors, enabling field supervisors to become more familiar with their areas of responsibility, reducing travel expense, and minimizing the itinerant character of field positions that tends to make them unattractive for career employment.

Good examples of well-planned field operations include the following. Wisconsin, traditionally an exponent of field supervision, recently increased the number of its district offices from four to six, bringing the most remote assessor within 120 miles of a State office. California's supervisory agency maintains general field services and, as described in volume 2, has conducted uniquely valuable local surveys in all primary assessment districts. In Kentucky, with its 120 counties, the central agency provides field service through 12 districts, with a fieldman in charge of each who calls on county

assessors, advises with them on problems, explains and encourages use of tools supplied by the agency, and may do some actual appraisal for the assessors. These fieldmen, without charge to the county, do a great deal of special work, such as appraisal of factories in rural areas, and also appraise real estate for State inheritance tax purposes and for State purchase of real property for other than highway purposes.

In Colorado, where a recently invigorated central agency is working to preserve the gains of statewide revaluation, the long distances and numerous large counties with sparse populations have prompted the development of an "assessor-consultant" system, with consultant assessors from the central staff located strategically around the State, each serving five to eight counties which have similar economies and problems and working with the county assessors in such ways as are needed. Hollis A. Swett, director of appraisals and equalization for the Colorado Tax Commission, has indicated as the two main problems in developing this system, the difficulty in coordinating a scattered field staff and in obtaining personnel with sufficiently broad training to cope with a diversity of technical problems.<sup>17</sup>

The great majority of local assessment districts are too small to be able to include on their staffs technical specialists for appraisal of the various complex types of property they may have to cope with. Alternative solutions of this problem are for the State to take over the assessment of all such property or to provide a reservoir of special talent on the State supervisory staff from which a local district can draw as needed. The latter solution is provided,

<sup>17</sup> See H. A. Swett, "Technical Assistance to Local Assessors," in *International Association of Assessing Officers, Assessment Administration, 1962*, pp. 102-107.

more or less, by a number of States in their technical aid programs. Several States furnish special appraisal aid rather informally in conjunction with field supervision, as noted in the instance of Kentucky and Colorado. In some States local districts may contract with the State agencies for special appraisal and other services. In several States the State agency appraises certain classes of property and recommends values for local adoption, and in a few States the central agency itself makes comprehensive reappraisals periodically as a basis for local assessment. In other words the de jure central assessing done by the States is supplemented by a considerable amount of de facto central assessing.

Most of these technical aid programs are described in volume 2, but a few illustrations will indicate something of the various policies and procedures. In Wyoming, where more than half the State's property valuation is centrally assessed, the State supervisory agency also regularly appraises all major industrial plants and various other structures, classifies land, and makes recommendations of value per acre for each class of land and of values for livestock that commonly are accepted by local assessors. The Minnesota agency makes a small appraisal staff available to work with assessors in appraising industrial, farm, and other special types of properties. The New Hampshire agency is authorized to aid local units, on request, in working on problems ranging from difficult appraisals to complete reappraisals, with the State to be reimbursed at cost. The California agency contracts for mapping and timber appraisal services at cost, while the Kentucky and Oregon agencies contract with counties for reappraisal services on a cost-sharing basis. The Oregon agency, as part of its

maintenance program following revaluation, contracts with counties to appraise major industrial property and keep tax maps up-to-date, while Maryland's central agency maintains all maps. Utah maintains a continuing State reappraisal on a 5-year cycle, mainly at State expense, of all real property, and is giving increasing attention to personal property.

The provision of a large part of this State technical aid is contingent on local requests for specific State services, to be given free, on some cost-sharing basis, or at cost. Illustrating the perverse home-rule influence that tends, in many States, to inhibit effective statewide supervision of an administrative function of statewide concern is the system of State assessing aid adopted in Massachusetts in 1955. For many years the general laws authorized the Commissioner of Corporations and Taxation to require of town assessors such action "as will tend to produce uniformity throughout the Commonwealth in valuation and assessments;" but as in numerous other States with laws granting similar powers, uniformity failed to develop. The legislation of 1955 provided for the creation of a State assessment system and in 1956 a bureau of local assessment was set up to administer the State system. The system provides State supervision of the methods of property valuation, establishment of standard requirements for assessing officers, special aid by expert appraisers, periodic surveys with recommendations for correcting weak spots, complete supervision of revaluation programs, and other services. The notable advantages of the State system, however, are available only to the cities and towns that vote to join it. There is a modest annual charge for service and any local unit can vote to withdraw from the system if it so wishes. Of the State's 351

cities and towns, 58 had joined by the end of 1962.

A limitation that appears to be common to most of the professional and technical aid programs is the inadequacy of their facilities. Either the authorized staff is too small, or the established salary schedule is too low to permit recruiting and retaining enough qualified technicians to keep up with local requests for assistance. It may be that legislatures are reluctant to provide adequate support because the programs represent so extensively a makeshift system—of doing work for local officials who lack the technical qualifications for their jobs, and of trying to provide on-the-job training for persons who should have had professional qualifications before induction to office. While a constructive alternative is the efficiently professionalized, coordinated, and directed system of joint State-local administration outlined in chapter 10, this is not a goal that can be reached overnight. In the meantime there is urgency to make the best possible use of temporizing arrangements, particularly to give some degree of permanence to the gains from the many costly revaluation programs completed or in progress.

#### *Training and Orienting of Assessors*

Pre-entry and inservice training have become increasingly useful procedures over the years to build up satisfactory personnel in the various career professions in public administration. Unfortunately the assessment of property for taxation has not been widely established as a career profession. Nevertheless, training programs for assessors and their appraisal staffs have long had some attention in a few States and in recent years have had increasingly widespread development. The gen-

erally prevailing organizational and personnel setup for assessment administration dictates to a large extent the character of the training problem, the nature and limitations of the programs, and the share that the State supervisory agencies should have in their conduct.

A small minority of assessment districts in the United States are sufficiently large and well staffed to provide for their own training needs, including internships for new recruits and inservice training through supervision, staff conferences, organized study programs, and inducements to pursue advanced professional school training.<sup>18</sup> As assessment districts decrease in size, however, their facilities for systematic training tend progressively to diminish, and the great majority of districts are unequipped for this necessary function, particularly because very many of them are one-assessor or one-assessor and one-assistant districts where the assessor himself has had little or no professional training. To some extent this deficiency is being overcome by training programs promoted or developed variously by the assessors' and appraisers' own professional organizations, State leagues of municipalities, college and university schools and institutes of government, and State supervisory agencies, often with cooperative sponsorship.

<sup>18</sup> The Los Angeles County Assessor's Department conducts an outstanding program of this type for carefully selected college graduates who wish to train for the position of appraiser. The trainees, 10 to 20 in classes starting twice each year and extending for a full year, are given classroom instruction in the theory of appraising, followed by supervised field assignments combined with further instruction. They receive monthly ratings and must pass a series of four examinations. They receive compensation during the training period and staff positions are held open for them. (See Gerald W. Miller, "Recruiting and Training Appraisers", in *Assessors' Newsletter*, International Association of Assessing Officers, Chicago, May 1962.)

When and if the States professionalize the assessment function, there will be a state-wide demand for pre-entry and internship training. There would not be much point in establishing professional qualifications for all assessors and appraisers, in fact, unless there were enough persons available who met these qualifications. As the Maine Bureau of Taxation said in its 1958 report, "If assessment organization is modernized to the point where technically qualified assessors are required, obviously there must be some source from which such persons can be recruited." As a step in this direction the bureau undertook a limited training program "for personnel who might be expected to remain with the bureau for 1 or 2 years and who thereafter might be available to fill vacancies in the local assessing field."

Desirably, the educational equipment of an appraiser should include, in addition to the broad background of a college education, a year's internship, with specialized instruction, supervised field assignments, and periodic examinations, which should carry maintenance pay and good assurance of a career position upon successful completion of training. As part of any program for statewide professionalization of assessment, the State supervisory agency should cooperate with educational institutions in planning and conducting pre-entry courses of study, and, in cooperation with local assessors, it should plan and participate in internship training programs.

*Inservice training.* Inservice training, the present focus of attention, has a dual objective. On the one hand, it tries to ground newly elected assessors in the rudiments of their duties, and because of the turnover in elected officers it must continue this elementary procedure in endless and wasteful repetition. On the other hand, it

seeks to perform the true function of inservice training by advancing the professional capabilities of the personnel who have tenure or some approximation thereof by appointment or repeated reelection.

There is no satisfactory substitute for the continuous inservice training, much of it informal, provided by competent, well-equipped State supervisory agencies through provision of manuals, guides, and other assessing tools along with personal instruction in their use by means of field service and regional conferences and schools, collaboration of technical staffs in solving difficult assessment problems, guidance in measuring and analyzing assessing results, and broadening the local assessor's range of professional equipment by acquainting him with the best technical reference material and the wealth of aid available in the publications and services in numerous Federal and State government departments and agencies and in the State colleges and universities.

Valuably supplementing such training, and sometimes attempting to meet needs that weak State supervisory agencies have failed to satisfy, are the types of formal inservice training which have been developing rapidly in recent years. In about one-half the States 3-to-6-day assessors' schools are held annually at which specialists present papers on technical and legal problems of assessment, seminars are conducted, and particular appraisal techniques are demonstrated. These schools usually are joint undertakings of the State supervisory agency, a college or university, and the State association of assessing officers, and quite commonly they use the facilities of the college or university campus. The chief sponsor may be the State agency, under legal requirement or authorization, but in a few



instances the agency is merely a participant. Several universities are cooperating in inservice training through the conduct of extension courses, correspondence courses, and advanced seminars.<sup>19</sup> The value of well-conducted programs of these types appears sufficient to justify authorization by all States of their sponsorship and encouragement by the State supervisory agencies, with reasonable financial provision for the purpose, as well as authorization for local assessment districts to defray the basic participation expenses of assessors and other qualified personnel.

While most of these inservice programs necessarily begin with rather elementary goals of instruction, which to some extent they must continue to adhere to,<sup>20</sup> some of them have helped to generate a demand for more advanced training. Georgia has divided its school into three sections—basic, general, and technical. In Virginia, the school sponsored jointly by the university and the State association of assessing officers has developed a 5-year course divided into five parts, the last three for the more advanced personnel. In the annual school held at the University of Minnesota a written examination was initiated in 1960, with a plan to designate as senior assessor any assessor who passed three annual tests. The university also instituted a special, 2-week seminar limited to 30 assessors. In Oregon, the requirement that all real property must

be assessed by appraisers with State certified qualifications has permitted increasing sophistication of the program for the annual appraisal school conducted jointly by the State Tax Commission and Oregon State University and brought requests from the certified appraisers' newly formed association for credit-carrying university courses in property appraisal.

*Professional self-advancement.* In the gradual emergence of scientific assessing by trained assessors which has been in progress since the turn of the century, the assessors themselves have had an influential role. Assessors in some of the municipalities that began modernization of their fiscal administration in the early 1900's contributed importantly to the development of systematic methods of appraisal. Outstanding assessment operations in some localities have set patterns for wider progress, and the development of assessors' professional organizations has produced collaboration in the study and improvement of assessing standards.

Following the development in several States of assessors' organizations, a National Association of Assessing Officers was formed in 1934 with headquarters in Chicago, its name changed in 1959 to International Association of Assessing Officers. Presently it has a membership of over 3,000 and serves affiliated associations of assessing officers in 32 States, Puerto Rico, Philippines, and 7 Canadian provinces. Through 1962 the association had conducted 28 annual conferences whose published proceedings contain valuable reference material on all aspects of the assessment process; through its headquarters staff it provides research and information services for members and aids State associations in their programs; its study committees have produced important

<sup>19</sup> Representative individual State programs are summarized in vol. 2.

<sup>20</sup> In Kansas, where assessors are elected for 2-year terms, the State manages to introduce a degree of progression in this elementary instruction. In election years, the State Property Valuation Department, shortly after the election, conducts a school for all newly elected county clerks (who in most instances are the assessors) on the detailed work of their office. In off-election years the department holds a school for all county assessors on assessment and taxation problems.

technical monographs; and it awards the designation Certified Assessment Evaluator (CAE) to assessing officers who meet searching prescribed tests, held by 116 members at the end of 1962.<sup>21</sup> Some of the State associations are professionally strong, have considerable legislative influence, carry on study programs, and cooperate with the State supervisory agencies and universities in the development of inservice training and preparation of appraisal manuals. A few of them have developed their own systems and titles of certification for technically qualified members.

In the early years of the IAAO a distinguished committee of the association, under the chairmanship of James W. Martin and with the editorial and research work done by Ronald B. Welch, produced a report on assessment organization and personnel, published in 1941, which continues as the definitive work on this subject. Notable among the recommendations are those involving the role of State governments in assessment administration. In brief summary, they took the stand that: (1) In numerous States the assessment district pattern is a major obstacle to improved assessment administration and needs specified lines of correction. (2) Overlapping assessment districts can be eliminated if the States remove the causes, all of them dispensable, for their continuance. (3) Numerous types of property do not lend themselves well to local assessment and should be centrally assessed. (4) Professional qualifications for assessors should be established and candidates examined and certified. (5) "The State tax department, or some similar agency, should supervise local assessors whether or not the

State imposes a property tax for its own support."

#### *Enforcement of Assessment Standards*

Thus far consideration has been given to a State agency's responsibilities for fact-finding and analysis as a means of knowing the problem, for providing or helping to provide certain assessing tools, for supplying professional and technical services, and for aiding in the training and orientation of assessors. All of these activities are directed to the attainment of good quality assessing, but the agency's supervisory authority, and facilities for its exercise, should extend to investigation of complaints, continuous search for substandard assessing and its causes, and power to correct mistakes, issue orders and enforce compliance.

While the supervisory agency's most desirable and constructive means of inducing satisfactory performance are competent aid, advice and cooperation, the agency should have adequate legal power to issue and enforce orders. Good supervision under these conditions excludes dictatorial methods but includes the courage to take drastic remedial action when necessary. The issuance of orders and imposition of penalties are a last resort when suggestions and recommendations have gone unheeded.

In keeping with its administrative supervisory functions, the State agency should have specific regulatory powers respecting the quality of assessing, among them the following:

To issue rules and regulations for assessment administration.

To require the observance of local office and personnel standards determined by the legislature, such as the installation and maintenance of tax maps and record systems and employment of a prescribed quota of property appraisers.

To order or institute reassessment of (a) individ-

<sup>21</sup> In Maryland, a recipient of this award automatically receives an increase in salary.

ual parcels or items of property, (b) individual classes of property, (c) all property in an assessment district.

To order or institute equalization of average assessment levels when, although there is reasonable uniformity of assessment within individual classes, there is a lack of uniformity among classes of property or among the various sections of a district.

To order or institute the assessment of omitted property. If all local districts have good tax maps and appraisal records, little action will be required for real property; but there may be an abundant opportunity to discover and require the assessment of personal property.

To require correction of errors in the classification and exemption of property, and of clerical mistakes.

Most of these items represent responsibilities that are now given to some State agencies, and some of them, responsibilities that are now conferred, under various conditions, on local and county review boards. All need to be clearly the responsibility of the State agency in the first instance, and to be recognized as an integral part of assessment administration.

If persuasion fails to obtain compliance with its orders, the State supervisory agency must have adequate powers of enforcement. Recourse to the courts is one possible line of action. According to the prescribed procedure in Oregon, for example, if it appears to the State Tax Commission that an assessor has failed to comply with the law or the Commission's related rules, the Commission after a hearing of the facts, may issue its order directing compliance. If the assessor fails to comply with the order within 10 days the Commission may apply to a judge of the circuit court of the county in which the assessor holds office for an order, returnable within 5 days, to compel him to comply or to show cause why he should not be compelled to do so. Any order issued by the judge is final.

Penalizing financially the local government involved has been tried in a few States. In Arkansas, a portion of a county's State aid is withheld if the county assessor fails to assess at the prescribed level, a provision which appears to have aided materially in inducing compliance. Since 1955, West Virginia has had a system of penalties, revised from time to time, for counties failing to raise assessments to the prescribed level, and also has made noncompliance by county assessors (and county courts serving as boards of equalization) grounds for proceedings for removal from office.<sup>22</sup>

In several States the State supervisory agency may remove a local assessor from office for such causes as neglect of duty and failure to comply with the tax law, subject to providing him a hearing, and in close to one-half the States the supervisory agencies may institute removal proceedings (with removal usually by court order but in a few States by the governor). In most of these States the assessors are mainly elected officers, not subject to much local administrative control. Thus these State removal powers would seem to offer considerable protection to the taxpayers, but in fact they are very rarely used. Under Maryland's effective arrangements, the State Department of Assessments and Taxation appoints all county supervisors of assessments and examines and certifies assessors for local appointment, and may remove supervisors and assessors at any time for "incompetency or other causes."

While assessors usually are locally elected or appointed officers, their duty is administration of a State assessment law, and they are, or should be, under the careful supervision of a State administrative agency.

<sup>22</sup> For details of these provisions in Arkansas and West Virginia see vol. 2.

This agency lacks the full authority and ability to act with simple efficiency that it needs to carry out its responsibilities unless it has the power to remove from office, after a hearing, any assessor who wilfully disregards the agency's orders—and would disclose its incompetence if it failed to use such authority in situations where its use was clearly demanded. Under the setup for effective joint State-local assessment administration outlined in chapter 10, the inclusion of such authority would be required, as well as authority for the State agency to withdraw as well as grant certifications of competency to assessing officers.

As an alternative to placing great reliance on penalties, which State supervisory agencies have shown reluctance to use and legislatures have tended to ameliorate if the agencies did attempt to use them, a State may be able to improve local assessment administration by the use of a well-devised system of incentive aid. Such a system might provide, for example, for the partial reimbursement of the expenses of any assessment district that met approved equipment, personnel and assessment performance standards. Several States use inducement aid in more or less limited ways, sometimes mainly to overcome local resistance to State sponsored assessment reform.

*Identifying and assuring satisfactory assessment.* Probably the surest remedy for local weak spots in assessing, for a State that is seriously intent on establishing and maintaining good assessment standards on a statewide basis, is for the legislature to set specifically the low boundary of assessment performance that it will tolerate and require that any district whose assessing falls below this level for more than a specified period of

grace shall have its assessment administration taken over and conducted by the State agency at the district's expense.

The efficacy of this plan depends on a specific mandate to the State agency from the legislature, including the spelling out of criteria to guide that agency's action. Legislative action necessarily would be based on thorough study, analysis, and testing, with the aid of the supervisory agency and other consultants, of the standard of assessing that is clearly feasible of attainment throughout the State. The take-over signal might be, for example, a combination of (1) failure to maintain adequate tax maps and record systems, (2) failure to meet minimum personnel requirements, and (3) assessments disclosing an index of inequality clearly in excess of a specified minimum level of toleration.

#### CENTRAL ASSESSMENT OF PROPERTY

In the great majority of States some property is centrally assessed. This includes property in 40 States subject to the general property tax, mainly railroad and other public utility property, whose assessment problems are reviewed in chapter 13, but in a dozen States includes various other types of real and personal property, as summarized in chapter 10. In many States some classes of intangible personal property are centrally assessed for special property taxation at low rates. What constitutes an efficient, clearly identified apportionment of assessment responsibility between State and local agencies, with equitable treatment of the taxpayers, is one of the major considerations in any comprehensive effort to strengthen assessment administration.

This division of assessment responsibility does pose some difficult problems, among them how to equalize State and local assessment of property subject to the general property tax and how to draw the line clearly between State assessed and locally assessed property. The equalization problem is more likely to be solved, or is in a better position to be solved, if central assessment is one of the functions of a single State supervisory agency fully responsible for the State's share in administering the property tax, rather than a function of separate agencies. The appraisal specialists performing this function are then under the direction and guidance of an agency director responsible for coordinating the entire State-local assessment operation, and they can draw from, and contribute to, the agency's valuation research. This unification of State general property tax responsibilities (as well as special property tax responsibilities when administratively justified) in a single agency does not preclude that agency's use of the technical skills of other agencies and departments. As an alternative to expanding its staff of specialists, the agency may find it more economical and more quality-producing to rely, for example, on the office of forestry for timber appraisal, or on a department of conservation for the appraisal of minerals; but coordination is lost if these are independent operations.

Any blurring of the allocation of assessing jurisdiction contributes to administrative confusion and may either confuse the taxpayer or give him opportunities for evasive tactics. "The problem is particularly acute," according to one authority, "where it is clearly to the interest of the taxpayer to have his property assessed by one of the two agencies because of differences either

in assessment policies or in tax rates."<sup>23</sup> One of the most conspicuous complications arises in the fragmenting of responsibility for the assessment of property of public service enterprises. The allocation may be on the basis of size, distinction between operating and nonoperating property, distinction between real and personal property or between kinds of real property, and the like, often tending to increase the cost of assessing and chances for defective or omitted assessments and the cost and complexity of taxpayer compliance. The policy in some States of State appraisal of certain types of property with recommendations for local assessment offers another opportunity for clarifying simplification by giving the State the assessing authority for such property. This does not rule out, however, the desirability of some cooperative assessing, with the State agency setting values and the local agencies doing the listing and enumeration.

#### *Criteria for Apportioning the Assessment Function*

The guiding principles as to what property should be State assessed and what property locally assessed necessarily are influenced by the character of a State's local assessment-district organization and facilities. If numerous districts are small and deficient in resources, a need for broad State assessing authority is indicated merely because of local incompetence to assess other than relatively simple classes of property. On the other hand, if a State has revamped its assessment district organization to facilitate efficient joint State-local assessment, the division of responsibility could be determined by such constructive considerations as how to obtain good-quality results in

<sup>23</sup> National Association of Assessing Officers, *Assessment Organization and Personnel*, *op. cit.*, p. 108.

the most economical way and which agency level is in a better position to discover and value the various classes of property.

Some years ago a committee of the International Association of Assessing Officers recommended sound basic criteria, which have lost none of their cogency, for determining what property should be assessed by State agencies. They are summarized here because of their applicability to present conditions.<sup>24</sup>

1. All property of a type which customarily lies in more than one local assessment district and which is more equitably or easily assessed as a unit than as a series of geographically isolated parts.

This criterion applies primarily to public service enterprises and, it will be noted, makes no distinction within a type for individual properties that happen to be located within a single district. State assessment of all such properties of a given type avoids duplication of specialized appraisal staffs.

2. Property of a migratory character which is constantly moving in and out of a State.

Involved in this classification are not only properties engaged in interstate transportation, such as commercial aircraft, but often roadbuilding machinery and other construction equipment. The problem of deciding tax situs tends to be one that local districts are poorly situated and equipped to handle.

3. Properties which are inventoried by State or Federal regulatory agencies.

Included in this classification would be some intangible personalty, some classes of tangible personalty,<sup>25</sup> and special classes of publicly regulated property which a State agency is in a better position to discover and

value because of its ready access to relevant data in the State tax department and various State regulatory agencies, and access to such Federal aids as income tax returns and some of the records of regulatory agencies.

4. Properties which are found in relatively small numbers in all or several local assessment districts, which are of considerable value, and which can be effectively appraised only by highly trained persons.

Included in this classification are such properties as public utilities, mines, oil and gas wells, minerals, timber and the like, all requiring appraisal by specialists. The volume of such work in most local districts does not justify maintaining a specialized staff, but a State agency can maintain such a staff economically for statewide use and also draw on the technical knowledge and services of other State agencies. Also, the spread of industry into scattered small communities has created a problem for which the best solution may be central assessment.

5. Highly standardized properties the value of which is little affected by location, provided State agency facilities for discovery are not inferior to those of local assessors.

This class includes intangibles and such other property as motor vehicles and whiskey stored in bonded warehouses (centrally assessed in Kentucky and Maryland). With values that are virtually uniform throughout a State, the State agency readily can establish valuation schedules, thus avoiding duplication of effort by local agencies and assuring statewide uniformity of assessment.

6. Properties whose tax situs is commonly altered, or thought to be altered, with the purpose of minimizing taxes levied on them.

This recommendation by the committee was directed mainly against negotiated assessment bargains and interlocal economic warfare through competitive underassess-

<sup>24</sup> *Assessment Organization and Personnel, op. cit.*, pp. 111-116.

<sup>25</sup> For outstanding examples of central assessment of personal property see the commentary on Ohio and Maryland in vol. 2.

ment, not uncommon practices in the instances of intangibles and the property of industrial plants.

## EQUALIZATION

The State's share of the administrative process of equalization, regardless of how broadly or narrowly this function is defined, is properly one of the major responsibilities of the central supervisory agency. The term "equalization" applies to three more or less distinct procedures in assessment administration.<sup>24</sup>

First, it is applied to important features of the procedure for obtaining uniformity of assessment of locally assessed property within an individual assessment district, namely, equalizing or putting on a uniform basis the average levels of assessment of the different classes of property, and in the various areas, of the district. In the plan of joint State-local administration under discussion, accomplishment of such equalization is, in the first instance, the responsibility of the local assessor, reinforced by the State agency's responsibility for supervision, as described above, and for issuance of equalization orders when necessary.

Second, as a special aspect of the first procedure, equalization also is the process of equalizing, or producing uniformity in, the levels of assessment of State assessed and locally assessed property. The purpose of this procedure, as in the instance of intra-district equalization of locally assessed property, is to help assure that all taxpayers in a taxing district will be taxed uniformly in

relation to the value of their property. Some of the problems of this phase of equalization are discussed in chapter 13.

Third, equalization is the term applied to the process of obtaining uniformity, or compensating for the lack of it, in the average levels of assessment among assessment districts throughout a State. For several important reasons, as discussed in chapter 4, it is essential to produce statewide uniformity by some kind of adjustment of these variations. When a taxing district depends on more than one assessment district for determining its tax base, interdistrict equalization of the assessment level is needed to provide a fair distribution of the tax burden. Such a district might be the State itself, a large school or special district, or, when the assessing is done by municipalities and townships, a county. Where this last condition prevails, the equalizing function usually is handled by county boards of equalization, a type of organization that would no longer be needed under the organizational setup advocated in this study. In the many collateral uses of assessed valuation for regulatory and measurement purposes, statewide equalization is necessary for equity and reliability.

One possible method of statewide inter-district equalization is for the State supervisory agency regularly to determine the deviation of the assessment level in each district from the prescribed standard and require conforming adjustments. Another method, described and advocated in chapter 6, is to permit all local districts to assess at the levels of their choice, subject to a minimum that is set as high as is feasible, with the State agency, on the basis of its regularly recurrent ratio studies, making equalizing statistical adjustments. Under what is called variable-ratio equalization,

<sup>24</sup> For thorough discussion and analysis of State equalization methods and procedures see National Tax Association, "Report of the Committee on State Equalization of Local Property Tax Assessments," *Proceedings* . . . 1958, pp. 316-365.

the tax rates or the assessed valuations in the various parts of a taxing district served by different assessment districts would be adjusted to account for assessment differences and there would be similar compensating statewide adjustments in the formula for the distribution of school aid. State-determined market value, rather than the assessed value, of taxable property would be used as the base for such purposes as setting tax rate and debt limits and the grant of partial tax exemptions.

### VALUATION RESEARCH

No State supervisory agency would be able to perform the functions and provide the services indicated as necessary for leadership in obtaining good quality assessing and advancing assessment standards without constant study and research. Only by

painstaking scientific determination of facts can there be any reliable basis for effective supervision and equalization and for checking systematically on the progress made in the quality of assessing.

Improving assessment methods and standards, recognizing and solving difficult problems of assessment, and coping with new problems as they arise depend on continuing valuation research. The professional morale of the entire State-local appraisal organization can be bolstered by the judicious attention given to such study and its practical application. Thus no agency is fully equipped for its job unless it has a competent research unit to provide the scientific facts needed by the supervisory staff and the local assessors in their work, and to study the special problems that endlessly emerge even for the most experienced practitioners in this difficult field of taxation.



## Chapter 12

### REMEDIES FOR THE TAXPAYER

Following the familiar adage that an ounce of prevention is worth a pound of cure, this study has emphasized that concentration on equitable primary assessment is the taxpayer's best protection. The taxpayer is entitled to an efficacious means of redressing inequities, however, and the availability of effective remedies, in itself, will stimulate the assessor to produce a quality of work that he can defend.

Under the equal protection and due process provisions of the Federal and State constitutions the property taxpayer is entitled to fair treatment in the apportionment of the tax burden and to a reasonable opportunity to be heard if he believes that there is error or inequity in his assessment; but protection under these rights is chimerical if the burden of proving his case is too onerous and the tribunal to which he must appeal is not well-constituted for the purpose. The small taxpayer, in particular, is helpless if he has no simple, inexpensive, and dependable recourse. While the provision of remedies has a long history, the States are only beginning to find any that are truly effectual.

The demand for remedies dates back almost to the beginnings of the property tax. For example, dissatisfaction with the work of the town assessors in New York produced a petition to the Governor of the Colonial Assembly in 1692 requesting:

. . . that there may be a certain method for the equal and proportionable assessing of subsidies, We doe pray his Excell. would appoint Commissioners in each respective county for the making of an Esti-

mate of their Estates, that for the future there may not be such uncertainties.<sup>1</sup>

From such origins there has developed a widespread hierarchy of administrative boards of review and equalization, agencies to which taxpayers can appeal for correction of mistakes and elimination of inequities in the assessment rolls as prepared by the assessors. Administrative boards of this type, authorized to hear and pass on the protests of taxpayers, and quite commonly to take some remedial action on their own motion, are adjuncts of most of the local assessment districts in most States and thus are many thousands in number. In a majority of the States, there also are State boards of review. Appeal to the courts from assessments or from the decisions of administrative review boards offers the taxpayer another avenue of redress. For the protection of the taxpayer the development of review and appeal machinery is truly prodigious; the only drawback is that most of it does not work very well.

Giving the taxpayer the protection to which he is entitled depends primarily on the solution of two major problems. The first is how to provide a really effective system of review, with an organization and procedure that are readily available to and usable by the small taxpayer as well as the large taxpayer, and that functions with assuring competence.

Second, even the most efficiently or-

<sup>1</sup> Quoted in F. D. Bidwell, *Taxation in New York State*, J. B. Lyon Co., Albany, 1918, pp. 12-13.

ganized system of review agencies, unless there is a clear, meaningful groundwork of legal principles and standards on which it can base its procedures and rulings, will have to operate in a chronic blur of uncertainty. If, for example, the law requires the assessment of property at full value but the assessor's figures appear to range around 25 percent of full value, does the review board give redress only to property over-assessed according to the legal standard or does it compound the illegal practice of the assessor by its own illegal action in reducing the assessed valuation of property assessed at 50 percent of full value? In the event that assessments in an area follow no discernible common level but range, say, from 10 percent to over 100 percent of full value, which is a far from rare situation, against what base does the agency rule on a taxpayer's complaint? Perfecting the organization of review agencies is rather fruitless, therefore, without clarifying the guiding standards for agency action.

### ADMINISTRATIVE REVIEW AGENCIES

The process of assessment review is concerned with passing judgment on the assessments of individual properties and may be either an administrative or a judicial process, the former of which is considered here. There is no uniformity of organization for administrative review among the States, or even within many States, and the titles of some agencies are misleading as to function.

#### *Local Review Agencies*

Typically, there is some kind of local administrative review agency for each local assessment district; but in several States where primary assessing is at the municipal and

township level the review agency is at the county level or there are such agencies at both levels, and in a few States some or all local assessing districts are not provided with local review agencies. These agencies are mainly independent organizations, but in a number of instances the primary local assessment agency is also the local review agency.

Local administrative review agencies commonly are boards of three or five members, though there is a scattering of considerably larger boards. Membership generally represents part-time service on boards that convene for temporary periods annually and compensation usually is on a modest per diem basis. There are limited exceptions, however, in which service is more extensive or even full-time and annual salaries are paid.

Membership on these boards very commonly is *ex officio*, comprising the elective city council, town board of trustees, or county commissioners or supervisors, or some combination of other local or county officers, including, in some instances, the assessor. In a few States the members of some or all boards are elected by the people for terms ranging from 1 to 4 years. In several States the members of some boards, or some members of boards, or the members of all boards are appointed—variously by the mayor, the county commission, the county court, an *ex officio* board, or, in a few States by the Governor or other State officer.<sup>3</sup>

The qualifications for members of local boards of review are mainly those that are general for local elective officers, namely,

<sup>3</sup> In Alabama, by the Commissioner of Revenue with the approval of the Governor, from local lists of nominees; in New Jersey, by the Governor with consent of the senate; in Oklahoma, one member of each three-member board by the State Tax Commission.

they must be residents and electors. Several States require them to be owners of real property, occasionally there is a long-term residence requirement, some laws have such discriminating qualifications as "intelligent discreet householders," occasionally ex officio members include a local finance officer, clerk, or other official presumed to have special qualifications, and some boards must have a bipartisan membership; but rarely are there any specified professional qualifications. Among the few efforts to correct this weakness on a statewide basis is Iowa's plan of ex officio county and city conference boards with responsibility for appointing not only the assessors but the boards of review, which must include in their membership of three or five a licensed real estate broker, a registered architect or experienced builder, and, in county jurisdictions, a farmer.<sup>3</sup> With the purpose of trying to make the existing local review system work, some State supervisory agencies are empowered to supervise the local boards of review. The Oregon State Tax Commission, for example, issues a manual for county boards of review, assists them in various ways, and conducts a 1-day school annually for board members.

Interstate, and even intrastate, variations in the jurisdiction of local boards of review preclude more than a rough generalization of their responsibilities. The agency may be authorized to perform any or all of the following functions: correct clerical errors in the assessment roll; correct errors in the exemption or classification of property; add omitted properties to the roll, after giving the taxpayer due notice and opportunity for a hearing; lower individual assessments;

<sup>3</sup> See vol. 2, Iowa. For an account of the operations of the board of review in Des Moines, a precursor of the State program, see R. T. Harrison, "Assessment Review in Des Moines," in *Assessment Administration, 1961*, op. cit., pp. 156-160.

raise individual assessments, after due notice and opportunity for a hearing. In these matters the agency may be authorized to act on its own motion or only on appeal. When it acts on its own motion it is, in effect, performing a supervisory function. When it acts on appeal it is serving in a quasi-judicial capacity.

The preponderance of local boards of review are not well constituted to protect the taxpayer; like the elective assessor, they represent largely a rudimentary administrative carry-over from the last century. The statement that "most local review procedure is farcical"<sup>4</sup> is echoed in varying degree in numerous tax surveys and tax study commission reports.<sup>5</sup> The predominating membership of these boards is ex officio, comprising persons elected to other offices which are their principal responsibility, and they are

<sup>4</sup> W. J. Shultz and C. L. Harriss, *American Public Finance*, 7th Edition, Prentice-Hall, Inc., 1960, p. 387.

<sup>5</sup> For example, "The extent of the activity and of the effectiveness of local boards of review varies considerably. In some cases, the meeting is a mere formality. Typical procedure at such a meeting is to spend a few minutes waiting for complaining taxpayers to appear, then sign the assessment books and adjourn. Other boards make quite a number of changes . . . The lack of familiarity of most review board members with assessment procedures and the natural reluctance of an elected board to arouse opposition by making changes lead many boards to do little or nothing . . . At least one county assessor insures that the boards have some familiarity with the assessment list by reading it aloud at the board meeting." (*Report of the Governor's Minnesota Tax Study Committee, 1956*, p. 161.)

Among the findings of a survey of ex officio county boards of review in Washington in 1954 were: that "Gross distortions in property assessments are undergoing little or no substantive correction by the county boards of equalization" . . . The boards "have, in effect, abdicated their function of assessment equalization" . . . the boards in the counties where "assessment inequalities tend to be the greatest, are, in general, doing the least . . . to correct discriminatory assessments" . . . They "have shown little or no interest in ascertaining the existing levels of assessment" and "tend to act without reliable information . . ." (James K. Hall, "Assessment Equalization in Washington" in *National Tax Journal*, December 1956, p. 323.)

not likely to have been elected because of any special qualifications for this part-time review function. There is no assurance that directly elected members are any better qualified professionally for the job. Typically, the local review board member does not have readily available the basic information that he needs to make sound decisions.

#### *State Review Agencies*

In over half the States there are State administrative agencies with authority to review property assessments. Most commonly this agency is the State tax commission, with power to act as an appeal agency as well as an assessing and supervisory agency. A 1958 survey of State administrative tax review agencies found 11 States with boards of tax appeal set up independently of the State revenue departments for the exclusive purpose of passing on tax complaints, but not all of them concerned with property tax appeals.<sup>6</sup> The separate State administrative review agencies dealing with property tax appeals include, notably, the Massachusetts Appellate Tax Board, the Maryland Tax Court, and the New Jersey Division of Tax Appeals. Kansas created a State Board of Tax Appeals in 1957 but has since added to its review function an equalization function, including the power to order complete reappraisals in local assessment districts. Ohio's State Board of Tax Appeals, set up in 1939 as an autonomous board nominally within the Department of Taxation, was given not only quasi-judicial functions but also the responsibility for supervising the local assessment of real property.<sup>7</sup>

The Massachusetts Appellate Tax Board appears to be meeting well the qualities

of independence and impartiality to be desired in a State administrative board of tax appeals. Appeals from local assessments may be taken to the county commissioners or directly to the Board, the latter course being followed universally, and appeals from the Board lie to the supreme judicial court of the Commonwealth. Created in 1937 as an improved successor to a long-evolving line of State review agencies, the Board comprises five members, no more than three of one party, serving full-time, appointed for 6-year overlapping terms by the Governor with the advice and consent of the Governor's Council. This State administrative agency for review on appeal serves both large and small taxpayers effectively and economically. The entry fee is quite nominal, \$2 for a small homeowner, and the taxpayer need not be represented by counsel. Both formal and informal procedures are provided, the latter a ready, inexpensive procedure for the small taxpayer in which he waives any right of appeal to the supreme judicial court except on questions of law. Appeals on assessed valuations of \$25,000 and less are heard and decided by a single member; appeals from \$25,000 to \$50,000 are heard by a single member and may be decided by him if there is prior written agreement by the appellant; larger appeals may be heard by one or more members but decisions are by the full Board.<sup>8</sup>

In 1959 Maryland created two new State agencies to conduct separately the administrative and appellate functions formerly performed by the State Tax Commission—a Department of Assessments and Taxation

<sup>6</sup> Federation of Tax Administrators, *State Administrative Tax Review*, Chicago, 1958.

<sup>7</sup> For further commentary on these agencies see vol. 2.

<sup>8</sup> For a good analytical review of this plan, see John Dane, Jr., "The Experience of Massachusetts," in National Association of Tax Administrators, *Revenue Administration, 1958*, Chicago, pp. 37-41.

to administer and supervise the administration of the property tax and a tax court to hear tax appeals. The Maryland Tax Court, while patterned after the District of Columbia Tax Court and the model State Tax Court Act sponsored by the American Bar Association, is an administrative agency for constitutional reasons. The Court consists of five judges, appointed by the Governor for 6-year terms, one judge to be a resident of Baltimore, one of the Eastern Shore, one of the Western Shore counties, and two at-large, with no more than three of the same party and each a taxpayer and qualified voter of the State. At least two judges must be members of the State bar, one of whom the Governor designates as chief judge.<sup>9</sup>

The Court, a majority of the members constituting a quorum, has its principal office in Baltimore but is directed to sit for hearings in each of the county seats as necessary. Appeals, which are initiated by written petition, are not permitted until the appellant has exhausted his local remedies. Proceedings before the court are *de novo*; the Court is authorized to adopt its own reasonable rules of procedure; and it is not bound by the technical rules of evidence. Any person may appear and act for himself and attorneys admitted to practice before the Maryland Court of Appeals are authorized to practice before the Court. The Court "is empowered to assess anew, classify anew, abate, modify, change or alter any valuation, assessment, classification, tax or final order appealed from . . ." Any party to a proceeding may appeal from the Court's final order to the circuit court of any county or the Baltimore City Court where the property involved is located.

<sup>9</sup> *Tax Laws of Maryland*, art. 81, secs. 224-231.

## JUDICIAL REVIEW

Not only has administrative review failed widely to give the taxpayer satisfactory protection, but the State courts rather generally have not provided effective judicial relief to taxpayers aggrieved by inequitable assessment. The remedial procedures available in the courts not only have been slow and uncertain but they have been accessible only to persons of means. A beginning has been made, however, in reducing these handicaps.

Taxpayer protests concentrate mainly along two lines of complaint, overassessment and unequal assessment; but for a number of years the generally prevailing underassessment has tended to center attention on the latter. In contending against unequal assessment the taxpayer has two legal bases of reliance. The State law requires uniformity of assessment, at least within classes of property, and the Fourteenth Amendment of the U.S. Constitution requires equal protection of the law.

The scope of judicial review granted by the State courts in contentions involving overassessment and unequal assessment has varied widely among the States. In an incisive summary of the appeal machinery in property taxation, Jerome Hellerstein has placed the courts of the several States in three broad groupings in this respect.<sup>10</sup> First, are the courts which restrict judicial review sharply to situations where the action

<sup>10</sup> Jerome R. Hellerstein, "The Appeal Machinery in Property Taxation," in National Tax Association, *Proceedings of the Fifty-First Annual Conference on Taxation*, 1958, pp. 431-441.

Reference should be made also to *Assessment Organization and Personnel*, *op cit.*, pp. 265-287, for a forthright analysis of judicial review which places the State courts in two groups, those which review assessments for legality alone and those which review assessments both for legality and for accuracy.

of the assessor has been fraudulent, arbitrary or capricious, or so unreasonable as to be tantamount to fraud, i.e., "constructive fraud." Second, are the courts that take a middle ground, reviewing only questions of law and not questions of fact, though the line of demarcation is itself a matter of uncertainty that raises legal issues. Third, are the courts in a number of States which, although recognizing that the burden of proof is with the taxpayer, exercise far broader reviewing functions, i.e., "the court approaches the valuation problem essentially as it would any other justiciable issue, to hear the evidence and make a judgment as to valuation, giving the assessor the benefit of a rebuttable presumption of the correctness of his assessment." These variations are influenced, obviously, by the statutory provisions and status of administrative review in the several States.

#### *The Equal Protection Clause*

Traditionally, some State courts have held that the taxpayer's remedy for inequality in his assessment is to institute action to obtain an increase in the assessments of all other taxpayers to the level of his assessment. The U.S. Supreme Court, frequently passing on issues involving the relation of the "equal protection" clause to questions of property assessment, long ago took the position that such rulings deny the taxpayer any remedy at all. In 1923, in the famous *Sioux City Bridge Company* case,<sup>11</sup> the Court ruled that the taxpayer's right is to have his assessment reduced to the percentage of true value at which others are taxed, on the principle that "where it is impossible to secure both the standard of the true value, and the uniformity and equality required by

law, the latter requirement is to be preferred as the just and ultimate purpose of the law."

For years this doctrine went unheeded by many State courts, but in 1946 it was given new prominence by a similar decision in a suit by Doris Duke Cromwell to obtain rectification of a glaringly unequal assessment.<sup>12</sup> The courts of New Jersey had long held that the taxpayer's remedy, when he was assessed unequally but at below the State's required full-value level, was to secure the raising of other assessments to the level of his assessment. The Supreme Court said that the constitutional requirement "is not satisfied if a State does not itself remove the discrimination but imposes on him against whom the discrimination has been directed the burden of seeking an upward revision of the taxes of the other members of the class." This decision had special interest as the precursor of a series of State court decisions that have been revolutionizing assessment procedure in New Jersey.

"As a result of these Supreme Court decisions," one commentator notes, "the State courts generally have recognized—albeit with startling exceptions—that the 14th amendment forbids intentionally unequal assessment as between properties of the same class and entitles a taxpayer who has proved such discrimination to a reduction to the level at which comparable parcels have been assessed."<sup>13</sup> This represents only limited progress. Unintentional unequal assessment can be just as damaging to the taxpayer as the intentional variety, but the courts require more than "mere errors of judgment" to support a claim of discrimina-

<sup>11</sup> *Township of Hillsborough v. Cromwell*, 326 U.S. 620 (1946).

<sup>12</sup> "Inequality in Property Tax Assessments: New Cures for an Old Ill," *Harvard Law Review*, Notes, May 1962, p. 1376.

<sup>13</sup> *Sioux City Bridge Company v. Dakota County, Nebraska*, 260 U.S. 441 (1923).

tion. Proving discrimination, furthermore, is an undertaking generally beyond the reach of the average taxpayer. By-and-large, the State courts have done little to effectuate for the taxpayer his legal right to assessment uniformity, but in very recent years the courts of a few States have lowered some of the barriers to remedial action.

#### *Avenues of Judicial Relief*

Taxpayer action to compel the reassessment of all property in an assessment district in accordance with the law is a very potent remedy; but it is very expensive, rarely used, and rarely successful. In two recent such cases, however, the failure of assessing officers to comply with the law received severe condemnation by the highest State courts. In *Switz v. Township of Middletown*,<sup>14</sup> where the plaintiff contended that her property was assessed far above the prevailing average level of 15 percent and sought a mandamus order to compel the assessment of all property in the township at full value as required by law, the New Jersey Supreme Court, in what Professor Hellerstein has called "one of the most momentous decisions in the property tax field in modern times,"<sup>15</sup> held that the mandamus order should be issued and declared that the legal standard of assessment would be enforced at the suit of any taxpayer, and so long as the standard set by statute remained at full value the courts would mandate that standard. Because assessing throughout the entire State was involved, the Court delayed enforcement of the decree to give the legislature and the assessors time to make adjustments.

The case of *Bettigole v. Assessors of*

*Springfield*<sup>16</sup> was a broad action in 1961 dealing with interclass inequality. While the Massachusetts constitution requires uniformity of assessment and the statutes require that this uniformity be achieved at "fair cash value," the assessors of the city of Springfield had set up six classes of real property and assessed them at various ratios of full value. This practice was contested by a group of property owners in the higher assessment range and the supreme judicial court of Massachusetts declared the plan invalid and enjoined collection of the entire tax levy.

While both the *Switz* and *Bettigole* cases demonstrate the efficacy of such sweeping means of remedying district-wide inequities that are virtually impossible to cure by individual private suits, they also disclose the unavailability of such action to the average taxpayer and the potentially disruptive side-effects of the remedy. In both cases the plaintiffs required substantial financial resources with which to press their claims (the *Bettigole* decision followed two unsuccessful suits), and in both cases there was the hazard that the essential operations of local government might be disturbed by the decisions. In the *Switz* case this danger was avoided by the court's deferment of enforcement of its order, and in the *Bettigole* case the court required assurance that the city had available the assessment data and facilities for quickly preparing new tax bills.<sup>17</sup> Both cases, moreover, emphasize the need for a quality of State administrative supervision of assessing that will obviate dependence on such drastic judicial action.

In ruling on individual private suits seeking relief from assessments that are dis-

<sup>14</sup> 23 N.J. 500 (1957).

<sup>15</sup> Hellerstein, *op. cit.*, p. 449.

<sup>16</sup> 178 N.E. 2d 10 (1961).

<sup>17</sup> For comment on these limitations see *Harvard Law Review*, *op. cit.*, pp. 1380-1381, 1386-1387.

criminary although below the legal standard of assessment, many State courts have been slow to grant relief in the absence of fraud or constructive fraud; but in the past few years the courts of several States have moved toward effectuating for the property owner the principle of the *Sioux City Bridge Company* and *Hillsborough* decisions.<sup>19</sup> For example, in 1954 the New Jersey Supreme Court, in the *Baldwin Construction Company* case,<sup>20</sup> held that under the constitutional provisions the taxpayers were entitled to a reduction of their assessments to the general level. In *Hamm v. State*,<sup>21</sup> the Minnesota Supreme Court in 1959 not only reversed the half-century-old decision in *State v. Cudahy Packing Co.*<sup>22</sup> that refused relief to property assessed at market value when property of the same class was assessed far lower, but apparently held that a taxpayer assessed at the class average could contest the validity of his assessment when some property of the same class was assessed at much lower percentages.

*Proving inequality.* The taxpayer, in contending that he is unequally assessed, has the burden of proving that his property is assessed at a higher ratio than that applied to property generally in the assessment district. Unless the State has taken steps to facilitate such determination he is faced with an onerous, expensive, and sometimes impossible task. In addition to proving the value of his own property, he may have to make appraisals of a large number of other properties in order to show the relationship between his own assessment ratio and the

average assessment ratio for other properties of similar type.<sup>23</sup>

The protesting taxpayer has less of a problem when there is a generally prevailing level of assessment for his class of property, and his property is assessed at a much higher level; but he faces a quandary when the generality of assessments, instead of approaching a common level, range so widely as to disclose a hit-and-miss variety of local assessing. Under this condition, which is not unusual, the court might be willing to consider a comparison with the average, if the plaintiff can prove what the average is, or it might hold that there had been no special discrimination against the plaintiff.

A few courts have recognized and simplified the problem of the plaintiff when there is no common level of assessment. In 1958, the Pennsylvania Supreme Court, in *In re Brooks Building*,<sup>24</sup> accepted as proof of inequality the valuations of a few comparable buildings with assessment ratios far below that of the plaintiff's property, with the observation that:

... it would be unjust and ridiculous to hold that since there was no fixed ratio of assessed value generally throughout the district, plaintiff failed to prove a lack or violation of uniformity which the Constitution requires.<sup>24</sup>

For more clear-cut relief to the taxpayer under these obscure conditions, the New Jersey Supreme Court, continuing a line of helpful decisions, in 1961 sanctioned a

<sup>19</sup> See Charles F. Conlon, "Judicial Views on Tax Administration," *Western Political Quarterly*, XVI (March 1963), pp. 5-13, for a discussion on this development.

<sup>20</sup> *Baldwin Construction Co. v. Essex County Board of Taxation*, 16 N.J. 329, 108 A. 2d 598 (1954).

<sup>21</sup> 95 N.W. 2d 649 (Minn. 1959).

<sup>22</sup> 103 Minn. 419, 115 N.W. 645, 1039 (1908).

<sup>23</sup> If the property is of a special type the taxpayer may, in some States, find himself thwarted by inability to find comparable properties for appraisal. In one recent Iowa case, for example, a farm machinery manufacturing concern that owned a small arms plant contested the assessment of the plant's machinery, but was denied relief because there was no similar property in the county for comparison. *Deere Manufacturing Co. v. Zeiner*, 247 Iowa 1364, N.W. 2d 527 (1956).

<sup>24</sup> 391 Pa. 94, 137 A. 2d 273 (1958).

<sup>25</sup> For comment on this and related Pennsylvania cases see *Harvard Law Review*, *op. cit.*, pp. 1384-1385.



method which seems worthy of adoption generally. In the *Kents* case,<sup>25</sup> the owners of three parcels of improved real estate in Atlantic City, where no common level of assessment existed and sales disclosed ratios for various classes of property ranging from two percent to 129 percent, sought to prove discrimination by introducing in evidence the city's average assessment ratio as determined by the State for the purpose of inter-area equalization. The Supreme Court, reversing the decision of the State division of tax appeals, granted the relief sought. The Court noted that "since the individual assessments vary within a wide range," the average ratio was not an ideal instrument; but observed that "Mathematical perfection in taxation is unobtainable, and hence relief should not be denied merely because the result lacks absolute precision."

The Court emphasized that a way must be found to grant relief from unequal assessment "upon an appropriate basis requiring the individual taxpayer to prove no more than sensibly can be expected of him;" declared that "It would be a sad reflection upon the judiciary and indeed upon all government if the rights of a taxpayer were to be diminished in proportion to the violence of the assault upon them;" and held that:

Where, as here, the record of sales indicates there is no common level for all or any class of real property and the assessors disavow any effort to achieve one, the average ratio should be deemed sufficient evidence of the level to which reduction should be granted in the absence of circumstances indicating that the average should be modified for that purpose.<sup>26</sup>

With due regard for the courage and in-

genuity of those State courts that have pioneered in more meaningful remedies for the property taxpayer, and for the indispensability of the appellate courts in passing on issues of property tax law, it seems unfortunate to have the whole State court system, often at the expense of clogging and delays, drawn into endless assessment controversies because of the extensive fatuity of primary assessment administration and defective provisions for administrative review. Also, as Hellerstein has pointed out in a forthright analysis of the review machinery,<sup>27</sup> when they do engage in broad review of assessments:

. . . The courts are thereby performing a function in which they are generally not adequately trained; judges are not experts in assessing property. The judicial procedure, with the inherent limitations in the case by case hearing of testimony of conflicting experts and the restrictive effects of rules of evidence, is not well adapted to producing the best assessment results. Moreover, court proceedings—with lawyers and experts fees, filing fees, and records and briefs—are expensive, and as a practical matter, ordinarily open only to large or affluent taxpayers, the consequence is that the larger taxpayer is given through court relief preferential advantage over the average taxpayer.

## EFFECTUATING THE REMEDIES

The foregoing summary of administrative and judicial review and appeal machinery discloses widespread shortcomings and delusion in the remedies available to aggrieved property taxpayers, but also gives some indication of how the flaws in the machinery can be corrected. The provision of dependable remedies, readily available to all taxpayers, is feasible if the States are willing to follow four drastic lines of action, namely, to:

<sup>27</sup> Hellerstein, *op. cit.*, pp. 438-439.

<sup>25</sup> *In re Appeals of Kents*, 34 N.J. 21 (1961).

<sup>26</sup> For an acute commentary on the *Kents* case see William Kingsley, "The *Kents* Case—A Remedy for Assessment Inequality," in *New Jersey Municipalities*, February 1961, pp. 4-8.

1. Develop a competent, effective review system.

2. Facilitate the use of this system by small taxpayers.

3. Provide the taxpayers with clearly usable means of proving inequality.

4. Safeguard such measures from bogging down in futility by providing administrable tax laws and efficient assessment administration.

#### *Creating Competent Review Systems*

So long as assessment administration remains a joint State-local undertaking there is need for a two-level review system: agencies at the local level competent to deal fairly and expeditiously with routine and less abstruse problems—and thus screen out readily resolved issues that should not be permitted to encumber the work of the upper-level agency—and an independent, impartial, professionally well-qualified appeal agency at the State level. Appeals from this agency to the appellate courts of the State would be limited to matters commonly referred to as problems of law. One essential in the creation of such a system is to avoid its encroachment on the administrative authority that is properly that of the assessors and the State supervisory agency.

*Local boards of review.* The illusion of permanence that surrounds traditional political institutions tends to pervade most present systems of local review boards. They are something indigenous that may be tinkered with but not discarded. Many States will face some difficulty, therefore, in the necessary task of clearing out all of the local review machinery that does not work, interferes with competent assessors and impedes the function of State supervision.

Inherent in the general run of local

boards of review is an element of absurdity. The picture may be that of an unskilled part-time board correcting the mistakes of an untrained part-time assessor, i.e., of the halt leading the blind; it may be that of a political board protecting a political assessor against uneasy taxpayers; or it may be that of the hazards faced by the proficient assessor in defending the product of his systematic appraisals against the opinions of a professionally unqualified and often politically minded board that lacks basic information and comprehension of assessment standards. The protection given the taxpayer by these agencies is limited at best and negligible more often than not.

With joint State-local assessment administration organized along the lines proposed in this report, the creation of a simple, effective review system would become quite feasible. A State's assessment organization would comprise a limited number of professionally staffed county and multicounty assessment districts and a central supervisory agency. Under this setup the local review agency might well be the assessment agency itself. This arrangement would give the taxpayer a legally safeguarded opportunity to present his case before a body that was better informed about taxable values in the local district than most outside boards could hope to be. By this means, a procedure, sometimes designated as the provision of a grievance period, that already exists in law or practice in numerous jurisdictions, would become the local component of the review process.

This arrangement may be criticized for its provision of a hearing before an agency seeking to defend its own performance rather than before a separate agency; but it has certain special advantages and is safe-

guarded by the right of appeal to an independent State review agency. Review by the local assessing agency, after the assessment roll is open for inspection, provides a direct, simple means of correcting administrative errors, taking care of minor misunderstandings and adjustments, and dealing with general types of assessment protests that a competent local assessing organization is in a better position to handle expeditiously and knowledgeably than an outside agency. Also, it should be emphasized, using the assessing agency to initiate the review process at the local level makes available the services of a full-time professional organization for a temporary function in a way that is not feasible for separate boards of review except in very large jurisdictions.

The taxpayer would be entitled to protest his assessment on grounds of overvaluation, unequal valuation, and illegal valuation procedure. He or his agent would initiate the proceedings by filing, between specified dates, an application for review on a form provided by the assessment agency. The application would specify whether a hearing was desired. To reduce the number of nuisance-type applications for a hearing, a filing fee of at least \$2 should be required. With the application, the taxpayer should be required to present in writing, for study by the reviewing officers, a reasonably complete summary of the reasons for the protest. The hearing should be before one or more members of the professional staff of the agency, not including, however, the appraiser who assessed the particular property under review—a restriction designed to produce a more detached evaluation of the protest. The procedure should be informal and the taxpayer should be entitled to appear for himself, with professional aid

if he wishes, or to be represented by his agent.<sup>28</sup> Under this procedure, it is easy for even the smallest taxpayer to obtain a hearing before a professionally qualified tribunal, and if he is dissatisfied with the ruling he can appeal to the State review agency. While the local assessment department, acting as a review agency, is not likely to be any more zealous to reduce assessments than are the typical ex officio review agencies which also represent local governments, it is bound to be influenced by the fact that it may be required to defend its rulings before the State review agency.

Only when there has been a suitable reorganization and professionalization of local assessment districts in a State is the foregoing arrangement feasible. Under generally prevailing conditions reliance would continue to be placed on separate boards of review as the local components of a State's review system. That scattered communities in some of the States have been able to develop boards of review of some competence suggests that such boards have a greater potential for taxpayer protection than they usually demonstrate. Realization of this potential, however, would seem to depend, first, on having jurisdictions of sufficient size and resources to support a well-equipped board. Where the township pattern of assessment districts still prevails the review board usually would need to be on a countywide basis, and the very many counties that are too small to support professional assessing also are too small to support a good review operation. In the sec-

<sup>28</sup> The taxpayer may find it desirable to use the services of an attorney, an appraiser, an economist, a realtor, or some other specialist; thus the procedure should not discriminate as to the type of bona fide professional representation permitted. It may be possible, however, to place administrative restrictions on abuses by professional assessment-reducers.

ond place, it would be necessary to replace ex officio and elective boards by boards appointed under some system that would assure selection of well-qualified members, posing a problem that has never been widely solved. In the third place, a review agency, in order to have some background of technical information to enable it to cope with its duties, needs the continuing full-time services of at least one professional adviser, a requirement that is difficult to meet because of the temporary or seasonal nature of the review function unless the district is large.

In any event, when assessment supervision is vested properly in a State supervisory agency, the local boards of review should serve exclusively as quasi-judicial bodies. When they, too, are made supervisory agencies there is groundwork for confusion and diffusion of responsibility. The State agency should be able to supervise local assessing directly, rather than in conflict with or acting through intermediate agencies of usually indifferent qualifications and sporadic concern with the problem.

*Independent State review agencies.* Review at the local level can dispose of the more readily adjustable grievances of the taxpayers, but this screening out process leaves unresolved issues that emphasize the need for an impartial, tax-sophisticated State review agency to which the taxpayers can appeal from the rulings of local review agencies and the assessments and some classes of decisions of the State supervisory agency, and find a speedy, inexpensive means of resolving their assessment controversies.<sup>29</sup>

<sup>29</sup> Such an agency would serve well, also, to hear appeals of assessors from rulings of separate local review boards and pass on certain tax grievances of other local government officers.

Such a remedy is not provided by appeal to the ordinary courts of the State, and it also is not provided by appeal to tax commissions, directors of revenue, and other agencies whose jurisdiction is confused by responsibility for passing judgment on the product of their own assessment and supervisory functions. As John Dane has commented, in evaluating the Massachusetts Appellate Tax Board, "No single man or group of men can be expected to be a tax collector and protector of the State's revenue for nine-tenths of the time and an impartial judge for the other one-tenth."<sup>30</sup> What is needed is an agency separate and distinct from the State tax department and outside the regular State judicial system, concentrating on tax questions and performing exclusively an appellate function.

Illustrating the type of State review agency that is advocated here are the Massachusetts Appellate Tax Board, described briefly above, and the quite similar instrumentalities envisaged in the model State Tax Court Act developed by the American Bar Association and made available in 1957. Maryland, as has been noted, created a State tax court in 1959 and Oregon followed with provision for a tax court that became operative in 1962.<sup>31</sup> The last two agencies are too new to permit evaluation of their work, but the Massachusetts Board has had a sufficiently successful operating record

<sup>30</sup> John Dane, *op. cit.*, p. 40.

<sup>31</sup> Hawaii was a pioneer in this field, having established a tax appeal court in 1932. The court consists of three members appointed by the Governor for overlapping 4-year terms, one of whom must be a lawyer and be designated as judge of the court. The court's jurisdiction, as well as that of the four county review boards, extends to appeals from all State administered taxes, which include property taxes. A taxpayer may appeal his assessment to the board of review or directly to the tax court; both the taxpayer and the assessor may appeal from the decisions of the board of review to the tax court; and appeals may be taken by either from the tax court to the Supreme Court.

over a period of years to give the State tax court concept more than theoretical attraction. Whether these tribunals for tax appeals should be called boards or courts probably is not of great moment so long as they have the necessary attributes, but the use of the term "court" may help to distinguish them in the minds of taxpayers from the various uninspiring boards long associated with the property tax.

These agencies are authorized to pass on appeals not only from valuations for ad valorem taxation but from assessments for State collected taxes. The members, varying in number with the size of the State and prospective case load, typically would be appointed by the Governor, on the basis of their qualifications for dealing impartially and skillfully with tax problems, to serve full-time for relatively long, overlapping terms of office. The model State Tax Court Act calls for five judges, appointed for 9-year overlapping terms, but three would suffice for some States and a few States might need only one. The court would sit at various places throughout the State for the convenience of the taxpayers, with authority for a single judge to hear small, uncomplicated cases providing flexibility for this purpose.

Appeals to the court or board would be on the basis of written application and would involve no more than nominal court costs. The proceedings would be *de novo*, the rules of procedure would be more simple than those of the ordinary courts,<sup>32</sup> and the objective would be expeditious adjudica-

tion, with the court empowered to affirm, decrease, increase, or cancel assessments, order rebates, and the like. The taxpayer could appear without a lawyer if he so wished. Decisions of the agency normally would be final as to the facts, and appeals on questions of law desirably should be on the basis of the record to the highest State court.

The Massachusetts board conforms more closely to these general specifications than do the Maryland and Oregon Tax Courts. Maryland followed the basic principles where legally feasible; but under its constitution the only way in which it could establish a tax court was to make it an administrative agency, which, in turn, because it was not a constitutional court, precluded appeals from it to the highest State court. It should be noted, in view of Maryland's limitation, that appeals from the Massachusetts Appellate Tax Board, New Jersey Division of Tax Appeals, and Ohio Board of Tax Appeals lie directly to the highest court. The Tax Court created in 1961 by the Oregon legislature to handle the appeals of property and other taxpayers is designed to free the State's regular circuit courts from concern with technical tax questions, become increasingly expert in the area of taxation, and be of special benefit to small taxpayers. Appeals from decisions of the court may be taken to the State Supreme Court. Departing from the concept of appointive judges, the Oregon tax court consists of a single judge popularly elected on a nonpartisan basis for a 6-year term, with the State Supreme Court authorized to appoint judges *pro tempore* as needed.

The creation of good machinery for tax appeals is an important and necessary step in effectuating remedies, but even the best machinery for this purpose will not function well unless it is operated by a highly quali-

<sup>32</sup> The rules of procedure in the model State Tax Court Act resemble those of the United States Tax Court, technically an administrative body as an independent agency of the executive branch and not a part of the Federal court system, and thus able to follow simpler procedure which hopefully would afford the taxpayer a speedier and more economical remedy.

fied personnel. The type of State review agency recommended here has a vast potential for protecting property owners against inequitable assessment, but only if the agency is given due prominence in the governmental organization and staffed with people of great integrity and courage and unquestioned experience and ability in the field of property valuation.

#### *Aid for the Small Taxpayer*

The small property owner is a helpless victim of inequitable assessment unless he has available a simpler remedy than that of hiring a lawyer, incurring substantial other expense, and facing formal proceedings before a court or even the less formal ordinary proceedings before an appeal board or tax court. "In some respects," as Hellerstein says, "the single most important problem in our entire property tax system, in terms of equality among taxpayers and the dissatisfaction of our citizenry with our tax system, is that of providing an informal, inexpensive and impartial forum, where the ordinary citizen can have his day in court, without formality, lawyers, delay, or the paraphernalia of a judicial proceeding."<sup>28</sup>

A small claims division, or a small claims procedure, in the independent State review agency whose adoption is advocated above can go far in providing the remedy which the small taxpayer now lacks. Both the Massachusetts Appellate Tax Board and the Oregon Tax Court have such provisions, the former long demonstrated by actual use as having much practical value and the latter still to be tested.

As indicated in the earlier summary of the Massachusetts Appellate Tax Board, two types of appeal may be filed—one under

formal procedure and the other under informal procedure. Under the latter, designed to provide a minimum of delay and expense for the small property owner, the appellant waives any right of appeal to the supreme judicial court except on questions of law raised by the pleadings.

The Oregon Tax Court law provides for a small claims division, utilizing the regular tax court judge or judges. The division's jurisdiction in the property tax field applies to real property having a true value, as determined by a board of equalization, of no more than \$25,000. The appellant pays a filing fee of \$1.50 and may appear on his own behalf or may have legal or other professional aid. The procedure is informal but all testimony must be given under oath. The court may hold hearings in any county seat. Once the taxpayer elects this procedure he may not revoke the election and has no further right to appeal or bring suit on the issue for the particular tax year. The decision does not set a legal precedent, applies only to the year in question, and may not be appealed.

#### *The Means for Proving Inequality*

Even when an aggrieved taxpayer has ready access to an impartial, competent tribunal with a simple, inexpensive procedure for reviewing his assessment, he still faces a serious obstacle to obtaining relief unless he has a ready means of proving inequality when assessments generally in his assessment district are at some undefined level below the legal standard or follow a wide and wandering range. The decision of the New Jersey Supreme Court in the *Kents* case in 1961, permitting the use of the State determined average assessment ratio as a basis for adjusting the plaintiffs' assessment, focused attention on the potential value of

<sup>28</sup> Hellerstein, *op. cit.*, p. 454.

assessment ratio studies in helping the taxpayer to prove discrimination.

Such ratios have been gaining some recognition in the courts and boards of review of several States, but in only a very few States have they received general acceptance as presumptive evidence of an existing average level of assessment on which taxpayers could rely in contesting their assessments. The Oregon legislature enacted a law in 1955 providing that a property owner, in petitioning a board of equalization or the State Tax Commission for a reduction of his assessment, has to show only that his property is assessed at a higher ratio than the average ratio determined annually by the county assessor and checked by the State tax commission by means of ratio studies.<sup>34</sup> In New York, under a law enacted in 1961,<sup>35</sup> the State established ratio for the assessment roll containing the assessment under judicial review may be introduced as evidence on the issue of whether the assessment is unequal.

The use of State determined assessment ratios to aid taxpayers in appealing their assessments was endorsed strongly by a study committee of the National Tax Association reporting in 1958.<sup>36</sup> The committee, noting the average taxpayer's otherwise impossible task of proving inequality, declared that:

If, however, the official assessment ratio findings of the State research agency were published, and if they were given some force in law, the taxpayer would be provided with the kind of machinery he

deserves to have. He would be relieved of the ridiculous necessity of determining his own facts for the presentation of protest, and the property tax would be relieved of what has, historically, been one of its heaviest burdens.

The committee considered various objections to the publication of assessment ratios and their use for this purpose, but insisted that "the taxpayer must be provided with more than a technical opportunity to object" and that it "cannot condone any frustration of the constitutional guarantee of due process, whether this frustration is overt or whether it takes the disguised form of requiring impossible proofs of the litigant."

The regular production and publication of assessment ratio studies, with statutory authorization of their use by taxpayers as evidence in appeals on issues of assessment inequality, are steps that no State can afford not to take if it is seriously intent on strengthening the property tax. A State should be warned, however, that they provide a double-barreled remedy—more equity for the taxpayer but also more grounds for discontent with the prevailing quality of assessment administration.

Before adoption of this policy a State should be well aware of the responsibilities and problems that it creates and be prepared to cope with them. For one thing, a State's assessment ratio studies will require development under sound statistical methods and procedures that will permit them to stand up under the scrutiny of property owners, assessors, review boards, courts, and their technical advisers. It is doubtful that these standards are being met presently by the ratio studies of more than a handful of States. Also, there are statistical problems to be solved and refinements to be worked out because of the numerous classes of property that would be involved in the

<sup>34</sup> Laws Relating to Assessment and Taxation, 309.410. See, also, vol. 2, Oregon.

<sup>35</sup> Real Property Tax Law, sec. 720(3) as amended by ch. 942, Laws of 1961.

<sup>36</sup> "Report of the Committee on State Equalization of Local Property Tax Assessments," National Tax Association, *Proceedings, 1958, op. cit.*, pp. 333-334.

protective use of the average ratios. It is obvious, too, that sound standards not only must be established but must be consistently maintained. Another issue that would call for resolution, in order to avoid misunder-

standing and misuse of this protective tool, is the degree of inequality that would constitute evidence of discrimination, i.e., determination of the reasonable range of tolerance.



## Chapter 13

### CENTRAL ASSESSMENT OF RAILROAD AND OTHER PUBLIC UTILITY PROPERTY

#### I. VALUATION AND ALLOCATION UNDER THE UNIT RULE

Among the problems of property taxation one of the most controversial and perplexing is that of administering the ad valorem tax on railroads and other public utilities. One solution would be to replace this complicated method of utility taxation with a more readily administrable tax in lieu of the property tax; but as one tax administrator recently remarked, "We probably will continue to tax utilities under property tax laws and constitutions requiring such taxes for a long time; therefore, efforts should be made to improve the efficiency and equity of the tax."<sup>1</sup>

Railroads and other public utilities are subject variously to local general property taxes in the great majority of States; a few States, however, apply special property tax rates to some or all classes of utilities or exempt them completely from property taxes in favor of other forms of taxation. Since the majority of local assessment districts are too small to employ appraisal specialists, and since the property of major utilities may extend not only into several assessment districts but into more than one State, the advantages of central assessment of this class of property are obvious; and in most of the States in which public utility property is taxed ad valorem, some or most major utility property is centrally assessed. Under this arrangement a State usually appraises each utility as a unit, apportions a

part of the value to itself if the utility is interstate in character, and allocates the value within the State among the local taxing units in which the property is located.

While central assessment of public utilities has notable advantages, actual and potential, it also has major problems. There is, for one thing, a considerable range among the States in the quality of assessment of such property. In the instance of interstate utilities, a tendency exists for States to allocate to themselves fractions of value that add to more than 100 percent of total value. Equitable intrastate allocation of centrally determined valuations to the local taxing units exists more in theory than in fact, and equalization of State and local assessment levels is considerably less than successful in numerous States. This chapter deals briefly with these problems and their possible solutions.<sup>2</sup>

<sup>1</sup>No recent comprehensive comparative study of State laws on the taxation of public utility property has been made. However, a good State-by-State summary of the assessing authorities for public utility property in 1957 is given in *Taxable Property Values in the United States*, *op. cit.*, pp. 3-4. A detailed table showing major types of utilities, their assessment and taxation on Jan. 1, 1953, may be found in *Appraisal of Railroad and Other Public Utility Property for Ad Valorem Tax Purposes*, National Association of Tax Administrators, Committee on Unit Valuation (Federation of Tax Administrators: Chicago 1954), app. A-1 (hereafter cited as "NATA Committee on Unit Valuation Report"). See also the discussion in ch. III of *Carrier Taxation*, House Document 160, 79th Congress, 1st Session (1944). A tabulation of 1958 showing assessment organization for utility and railroad property appears in *Final Report of the Joint Interim Committee on Assessment Practices to the California Legislature* (1959), app. E, pp. 98-112 (hereafter cited as "California Committee on Assessment Practices 1959 Report").

<sup>2</sup>E. L. Maynard, "Property Taxation of Electric and Gas Utilities," in *Proceedings*, National Tax Association, 1959, p. 250.

## GENERAL CONSIDERATIONS

The basic objective in the appraisal of public utility property for ad valorem taxation is the same as in the appraisal of other property for this purpose—finding the market value. The objective is entirely feasible; but because utility property differs in some respects from other classes of property, the methods that must be used to achieve the objective also differ.

*Appraisal Under the Unit Rule*

The unitary method commonly used in the central assessment of utilities recognizes that a utility is an integrated enterprise, and that its market value is not a summation of the values of its various physical components but its value as a whole as a going concern. As one appraisal expert explains the essence of a unit appraisal, “. . . separate appraisals of the rolling stock, right-of-way, ties, rails, bridges, and other structures of a railroad will not produce the value of the railroad as a common carrier of goods and services. Its value as a common carrier is derived largely from the particular way in which the rolling stock, ties, rails, and other things required to make it a going concern are put together into an operating unit capable of rendering transportation services.”<sup>3</sup> The same principle applies to other types of utilities. What a gas transmission system, for example, would sell for in the market cannot be determined by getting aggregate figures for the value of right-of-way and scrap value of pipe in the several assessment districts through which it runs.<sup>4</sup>

<sup>3</sup>C. M. Chapman in *California Committee on Assessment Practices 1959 Report*, *op. cit.*, p. 230.

<sup>4</sup>Central assessing evolved from efforts of the States in the last half of the 19th century to reach and tax the “going-concern” value of railroads. At that time values based on stock and debt value or earnings were generally

Under the unit rule, the central agency finds the valuation of a utility enterprise in its entirety, regardless of whether it operates in more than one local assessment district or more than one State. If it is an interstate enterprise, the agency must then determine the portion of the total valuation that is applicable to that part of the property located in its own State. If the central assessment under the unit rule is for purposes of local taxation, the valuation within the State of any utility located in more than one assessment district must be apportioned to such districts.

While a few States still cling to the local assessment of railroads, and a larger number to the local assessment of various other major utilities, it is evident that the local assessor faces considerable futility in trying to appraise a small segment of a large, integrated enterprise. Ordinarily he must use the so-called fractional method of valuation—“a valuation of one of the parts without reference to the value of the whole,”<sup>5</sup> and if he tries to employ some element of the unitary method he is likely to encounter trouble.<sup>6</sup> Conceivably, each local assessor

higher than values based on cost factors. See, for example, facts in *Atchison, Topeka & S.F. Ry. Co. v. Sullivan*, 173 Fed. 456 (C.C.A. 8th 1909). The right of the States to tax “going-concern” value measured by either or both stock and debt value or capitalized earnings was sustained in a series of U.S. Supreme Court cases commencing with the *State Railroad Tax* cases, 92 U.S. 575 (1875). A few other cases in the series are: *Pittsburgh, C.C. & St. L. Ry. Co. v. Backus*, 154 U.S. 421 (1894); *Cleveland, Cin., Chicago & St. L. Ry. Co. v. Backus*, 154 U.S. 439 (1894); and *Adams Express Co. v. Ohio*, 165 U.S. 194 (1896).

<sup>5</sup>NATA Committee on Unit Valuation, *op. cit.*, p. 2.

<sup>6</sup>For example, in an old and leading New York case on railroad valuation, *People ex rel. Delaware, Lackawanna & W. R.R. Co. v. Clapp*, 152 N.Y. 490, 494-495, 46 N.E. 842 (1897), the court, in rejecting a town's railroad track assessment based on capitalized earnings allocated per mile of track, said: “But to ascertain the value of a few miles of railroad in a country town upon a complex theory based upon the income or rentals of two hundred miles in this State of an intricate railroad system

could apply the unit rule, appraising the utility as a whole by use of the most appropriate evidences of value and allocating to his district a fair portion of the total value; but in practice the duplication of effort would be enormously wasteful (assuming that local assessment districts could afford the necessary facilities), and the conflict of results would produce utter confusion.

*What Utility Property Should Be Centrally Assessed?*

While most of the States in which public utility property is taxed ad valorem provide for some central assessment of public utility property, there is no uniformity of policy among States, or within States, as to what utilities, or what property of utilities, should be centrally assessed. For example, a State may follow one policy for railroads, another policy for telephone and telegraph companies, and still other policies for electric and gas companies. Again, with respect to a given type of utility, one State may provide for the central assessment of all property; another State, of all operating property; another State, of all property of companies operating in more than one assessment district; another State, of all operating property of such companies; and still other States, of only the personal property, or other specified segments of the property, of such utilities. This is merely an oversimplified illustration of what nationally is a virtually unclassifiable situation.<sup>7</sup>

extending into other States is impracticable, and, if permitted, would, in many cases, result in injustice." However, see *Boston Gas Co. v. Assessors of Boston*, 334 Mass. 549, 137 N.E. 2d 462 (1956), in which earnings were considered in assessing certain property located in Boston of a gas company operating in 19 other localities as well.

<sup>7</sup> See citations in footnote 2; also, see comparison of methods for railroads, pipelines, motor carriers, airlines and water carriers in Sydney L. Miller, "The Taxation of Transportation Facilities," *Proceedings, National Tax Association*, 1954, pp. 79-101.

Observance of a few basic principles regarding the most suitable jurisdiction for the assessment of utilities on which there is rather general agreement among the authorities would rationalize the arrangements for central assessment of utilities in many States. These principles may be summarized as follows:

1. Central assessment should be extended to all of the property used in the business of all classes of utilities which commonly are located in more than one local assessment district and which are more readily and equitably assessed on a unitary basis.<sup>8</sup>

What should constitute the unit for appraisal purposes needs clear determination. According to C. M. Chapman, "Fundamentally the unit should include all property used in the business, whether owned or not. It should exclude all property owned but not used in the utility business."<sup>9</sup> The conclusion seems unanimous that the unit should include all property used in the business.<sup>10</sup>

<sup>8</sup> The NATA Committee on Unit Valuation lists four factors favoring central assessment: (1) relatively large proportions of movable property; (2) operation over a wide territory; (3) complexity of the appraisal task; (4) regulation by a State agency. (*NATA Committee on Unit Valuation Report, op. cit.*, pp. 10-11.)

<sup>9</sup> Chapman, *op. cit.*, p. 234.

<sup>10</sup> James W. Martin, *Taxation of Public Service Corporations in Virginia*, Research Report of the Virginia Public Service Tax Study Committee, Richmond, 1947, p. 52; *NATA Committee on Unit Valuation Report, op. cit.*, pp. 17-22; John Austin Gronouski, *Valuation of Railroads for Ad Valorem Tax Purposes*, Doctoral Dissertation Series, Pub. No. 14,701, University Microfilms (Ann Arbor, Mich., 1955), pp. 23-31; Broley E. Travis, "A Survey of State Assessment of Property," *Legislative Council Report to the Colorado General Assembly: Public Utility Assessments*, Research Report No. 33, 1959, p. 43. (Hereafter cited as "Colorado Legislative Council Report".) See also, older discussions in *Proceedings, National Tax Association*, 1938, James W. Martin, "Application of Unit Railroad Assessment Basis Where Subsidiary Lines, Leased Line, and Trackage Rights Are Involved," pp. 174-178; George W. Mitchell, "Use vs. Ownership as a Basis for Taxation," pp. 284-292; George G. Tunnell, "Use vs. Ownership as a Basis for Taxation," pp. 318-322.

Borderline questions arise, however, over such items as trackage rights of railroads and, for all utilities, property jointly operated by more than one utility and property of subsidiaries. With respect to the inclusion or exclusion of nonoperating property owned by utilities there is less unanimity, since either course may pose special problems;<sup>11</sup> but when the property involved is similar to the types of property commonly assessed locally the case is strong for its local assessment.<sup>12</sup>

2. When central assessment is extended to some utilities of a given type, it should be extended to all utilities of that type, including those whose property lies in a single local assessment jurisdiction. Failure to do this results in wasteful duplication of specialized appraisal facilities and tends to deny uniform treatment for all utilities of the same type.

3. Central assessment should be extended to utilities which commonly are located within single local assessment districts when they lend themselves well to the unit rule of appraisal and when the central agency is in

a better position than the local agencies to assemble assessment information.<sup>13</sup>

4. The law should be so clear in its allocation of jurisdiction between State and local assessment agencies as to avoid any misunderstanding by the assessors and any confusion or opportunity for evasion for the taxpayers. When only the operating property of utilities is centrally assessed, the central agency should provide local assessors annually with identifying descriptions of the nonoperating property in their respective jurisdictions.

#### *Organization and Procedure*

Central assessment of major utilities under the unit rule is the most suitable method of assessment administration for this class of property, but it can be very unsatisfactory in practice unless the organization, procedures, and policies are designed to produce competent and equitable results.

Competent central assessment requires a suitable administrative organization and staff. As emphasized in chapter 11, this function should be performed by a section or division of a single State supervisory agency responsible for the State's share in administering the property tax, rather than by a separate agency. It needs to be under the general direction and guidance of an agency

<sup>11</sup> The chief reason for inclusion is the difficulty of measuring the portion of stock and debt value attributable to nonoperating property. The principal reason against inclusion is the problem of interstate allocation of a system value which includes nonoperating property located in other States. This property is and should be taxable only in the situs State. Gronouski concludes that the objections outweigh the advantages in the case of railroads. Gronouski, *op. cit.*, p. 37. The conclusion of the NATA Committee is not clear. *NATA Committee on Unit Valuation Report, op. cit.*, pp. 20-21.

For a summary of government units assessing nonoperating property of utilities, showing the lack of uniformity, see col. 12 of table in app. E, *California Committee on Assessment Practices 1959 Report, op. cit.*, pp. 98-107.

<sup>12</sup> As stated, e.g., by the NATA Committee: "there is a strong case for assigning nonoperating property to local assessment jurisdiction so that it will be assessed under the policies applicable to like properties in different ownerships." *NATA Committee on Unit Valuation Report, op. cit.*, p. 11.

<sup>13</sup> For example, in his survey of State assessment of property in California, C. M. Chapman recommended that privately owned water utilities and regulated air carriers be placed under the assessment jurisdiction of the State, the former, although located mainly within single counties, because the central agency was in a better position to assemble assessment information, and the latter, because "county assessors may be able to cover ground property but flight equipment practically defies local assessment." On the other hand, he recommended that jurisdiction to assess pipelines, flumes, canals, ditches and aqueducts not entirely within the limits of any one county be returned to the counties because "the nature of these properties is such that the unit rule of appraisal cannot be employed." (*California Committee on Assessment Practices 1959 Report, pp. 29-30.*)

director responsible for coordinating the entire State-local assessment operation. The technical staff must be adequate in specialized training, experience, and size to handle the specific functions to be performed, and it must be equipped with the working tools it needs. All too often the central agency's budget is deficient for both of these requirements.<sup>14</sup>

A second essential is a carefully drafted State law setting out the basic procedures and standards to be used by the central agency in each stage of its valuation and allocation functions. The law must provide clear guidance, but it should not be so detailed and rigid as to prevent the central agency from exercising the discretion and

<sup>14</sup> See discussion of State agencies and staffs in NATA Committee on Unit Valuation, *op. cit.*, pp. 9-12, and app. A-2 showing the number of official and staff members of the various State agencies. A tax administrator, Robert H. Allphin, discusses the problem of keeping a competent staff in "Railroad Tax Problems," *Proceedings*, National Tax Association, 1954, pp. 75-77. Note, too, the finding of the Colorado Legislative Council Committee on Assessment Methods, which had been assigned the task of studying public utility assessments in 1959: "The various errors of omission or commission of the Tax Commission referred to above are partly a result of the fact that the Commission has no staff assigned to gathering and analyzing data and making investigations upon which the Commission may base its value judgments. Assistance is needed also in checking data concerning the value of non-operating property and property otherwise taxed which must be deducted from unitary appraisals, and in checking data upon which interstate allocation of values and intrastate apportionment of assessments are made." *Colorado Legislative Council Report*, *op. cit.*, pp. ix, x. The tax representative of a California public utility has commended the work done by the State's Valuation Division as follows: "The process by which public utilities are valued has reached a highly developed state. Although there are still important differences of opinion with respect to specific issues in the valuation process, it seems fair to say that it is commonly recognized that the basic approach is a valid one and that the technical aspects are as scientifically conducted as possible." Leslie E. Carbert, "Property Tax Administration and Public Utilities," *Management's Stake in Tax Administration*, Tax Institute, Inc. (Princeton, N.J. 1961), p. 150.

judgment required.<sup>15</sup> Many of the statutes controlling public utility assessments were enacted years ago before the technical aspects of assessing under the unit rule were as developed as they are today, and the laws of some States provide precise formulas of valuation and allocation which the administrator must follow regardless of the distortion which may result.<sup>16</sup>

#### *The Major Steps Under the Unit Method*

Under the unit method of assessing the property of railroads and other public utilities, there are four major steps to be considered: (1) finding the market value of each public utility enterprise as a whole; (2) if the utility enterprise is interstate in character, determination by the assessing State of its share of the total value (interstate allocation of system value); (3) if the property is locally taxed, as in most instances it is, apportionment of the intrastate value among the local assessment districts and taxing units in which the property of the utility is located (intrastate allocation); and (4) equalization of the public utility assessment with assessments of other taxable property in the local assessing districts.

In the instance of intrastate utilities and utilities subject to property taxation only at the State level, not all of these steps are involved; but to the extent they are applicable they are important and present complex problems. All of the applicable steps must

<sup>15</sup> See, for example, the model law proposed for Virginia by James W. Martin, *Taxation of Public Service Corporations in Virginia*, *op. cit.*, app. B, p. 119. Many of the provisions in this model law were incorporated in the recently enacted Kentucky statute governing public utility property taxation (Kentucky Rev. Stats., SS136.120-136.180, as amended by ch. 186, art. II, Kentucky Laws of 1960).

<sup>16</sup> Colorado statutes specifying methods for interstate and intrastate allocation are illustrative of this. See discussion and recommendations of Broley E. Travis, *Colorado Legislative Council Report*, *op. cit.*, pp. 5-6, 70.

be administered well if the final assessments are to be equitable both for the public utilities and the other taxpayers. For example, a central agency might do a thoroughly competent job of valuation and yet stultify the final results by seriously defective allocation or equalization. The following brief discussion of the techniques involved in these four steps or procedures can do no more than touch the highlights in indicating those areas in which States may improve the administration of ad valorem taxes on public utility property.

Significant work has been done in the last decade to improve the assessment procedure for public utility property under the unit rule. As the references in this chapter disclose, State tax administrators and their professional organizations and legislative study committees and their professional consultants have made important contributions.

### VALUATION OF THE PUBLIC UTILITY SYSTEM

In appraising public utility property for taxation, the assessor has the same goal as in appraising common property—finding the market value. Since public utilities rarely are bought and sold, he must use other evidences of value than sales; but such procedure is not unique as it must be applied to various other classes of property. In being regulated enterprises, however, public utilities are measurably different from ordinary business enterprises, though in ways that vary among classes of utilities. Some utilities are free, or relatively free, from competition; but when their earnings are limited to a fair return on historical cost, the cost of duplicating the existing property after a long period of inflation provides little evidence of their market value. In the

instance of railroads, the competitive element is so controlling that authority to earn a fair return is illusory and a large amount of economic obsolescence may exist. Under such conditions, historical cost or reproduction cost provide even less evidence of present market value.

Some of the distinctions between utility enterprises and ordinary business enterprises are far from absolute—electric and gas utilities, for example, may compete with each other or have potential public competition, and railroads have no monopoly on economic obsolescence; but the fact that utilities are highly regulated enterprises has some part in determining the appropriate procedures for finding their market value.

Three types of value evidence will generally be available for consideration by the appraiser: (1) cost—original or reproduction; (2) capitalization of earnings; (3) stock and debt value.<sup>17</sup> There is a fourth which seemingly has been “the most influential of evidences” in too many States. This is the last or prior year’s assessment, which may have nothing to do with market value.<sup>18</sup>

Opinions have differed and still differ

<sup>17</sup> These are not the only evidences of value. The appraiser ideally should envisage the bargaining process which would occur between a seller and buyer of the entire operating unit, and consider also such additional factors as the population and industrial trends of the area, the competitive position, quality of present management, etc. *NATA Committee on Unit Valuation, op. cit.*, p. 22.

<sup>18</sup> Commenting in 1959 on railroad assessment, one authority said: “There are still other States where the current assessment is determined by taking last year’s assessment and adding or subtracting net additions or retirements. The assessor of one of such States very frankly stated that he proceeded on the assumption that someone in the distant past had found the value of the railroad and that this value determination became his guidepost. For many of this type of assessors, the logic back of ‘last year’s assessment’ remains a deep dark secret.” C. M. Chapman, “Property Taxation of Railroad Properties,” *Proceedings, National Tax Association*, 1959, p. 252.

considerably as to the relative merits of the three evidences as measures of market value. The result has been that today the professional appraiser advocates reliance on more than one, each serving as a check on, or test of, some aspect of the other and thereby indicating to the appraiser those evidences which should be given the greatest consideration.<sup>19</sup> The suggestion of one authority is appropriate here:

It seems clear that, regardless of how desirable it would be to have a standard formula for deriving the value of a railroad, the problems involved in valuation are not conducive to solution by rigid mechanistic procedures. This does not mean that the assessor should assess a given railroad from year to year solely on the basis of a "judgment" evaluation of the evidences. \* \* \* Valuation on a purely judgment basis can too easily degenerate into sheer guesswork or placing too heavy reliance on "last year's assessment."

It is suggested here that the assessor can avoid the pitfalls of both the standard formula and judgment approaches by treating each railroad operating in his taxing jurisdiction as a separate assessment problem. A careful and detailed analysis for each rail carrier of all relevant data \* \* \* can form the basis of the assessor's judgment as to the reliability of the primary value evidences as indicators of market value for the particular railroad under study. On the basis of his investigations the assessor can devise a separate valuation formula for each railroad, with its components weighted so as to best reflect market value in each specific situation.<sup>20</sup>

That some States apply a standard formula has at least been evident in the case of railroad valuations.<sup>21</sup>

<sup>19</sup> See paper of C. Blair Hutson, "Weighting the Evidences of Value in the Determination of a System Value," presented at 1958 Western States Association of Tax Administrators Conference.

<sup>20</sup> Gronouski, *op. cit.*, pp. 249-250.

<sup>21</sup> Recent cases showing that this has been the practice for some railroad assessments are: *St. Louis-San Fran. Ry. Co. v. Arkansas Public Service Commission*, 227 Ark. 1066, 304 S.W. 2d 297 (1957) (one-third reproduction cost, one-third capitalized earnings, one-third stock and debt value); *Chicago, Burlington & Q. R. Co. v. Dept. of Revenue*, 161 N.E. 2d 838 (Ill. 1959) (same as Arkan-

A description of each element reveals the comparative weaknesses and strengths.

### *Cost (Original or Reproduction) Less Depreciation*

One of the most hotly debated issues in the valuation field is whether cost elements should ever be used, and, if so, when and to what degree.

The precise definition of original (or historical) and reproduction cost which would be given by economists is not of much value in the taxation field, for the staffs of tax agencies are usually unable to make independent estimates of these costs. Thus these two terms, for practical reasons, are often used by the appraiser in the sense defined by the regulatory agencies, which prescribe the manner in which utility and railroad books are kept or which have made cost estimates for rate base purposes.

*Original or historical cost.* The usual meaning of original (or historical) cost for tax purposes is the cost incurred when the property was first acquired for public utility purposes.<sup>22</sup>

The rate base of regulated electric, gas, telephone and water companies is today generally predicated on original (or historical) cost less depreciation. When this is the case, the theory for using original cost for the tax valuation is that the cost figure becomes a measure of the possible earning

sas); *Chicago, Burlington & Q. R. Co. v. State Bd.*, 170 Neb. 77, 101 N.W. 2d 856 (1960) (one-third investment cost, one-third capitalized earnings, one-third stock and debt value). A similar tendency was shown by several Federal courts. The so-called 40-40-20 Rule (40 percent capitalized earnings, 40 percent stock and debt value and 20 percent reproduction cost less depreciation) was announced in *Northern Pacific Ry. Co. v. Adams County*, 1 F. Supp. 163 (E.D. Wash. 1932) and used with slight variations in *Western Union Telegraph Co. v. Wilcox*, 85 F. 2d 352 (C.C.A. 8th 1936) and *Grand Trunk Western R. Co. v. Brown*, 32 F. Supp. 784 (E.D. Mich. 1940).

<sup>22</sup> See discussion on definition, *NATA Committee on Unit Valuation Report, op. cit.*, pp. 50-54.

capacity of the enterprise since it is the measure of the amount upon which the utility may expect to earn the rate of return considered reasonable by the regulatory agency. Two assumptions must be made if original cost (or rate base) is to be completely relevant to market value: (1) the rate of return adopted by the regulatory body must be one that a purchaser would consider reasonable, and (2) the prospects are that the utility will earn the amount estimated by the regulatory body.

One commentator, after pointing out that in inflationary times more often than not there is a continual deterioration in the earning position of utilities not fully allowed for in the rate, submits that historical cost tends, at present, to mark the top of the range within which market value is to be found.<sup>23</sup>

The cost figure as used for the rate base should in all cases be adjusted before being used for tax valuation. Taxable property not in the base (such as construction work in progress) must be added and nontaxable property excluded. Sometimes the depreciation reserve permitted by the regulatory agency is not acceptable for tax purposes.<sup>24</sup>

In some States, original cost (sometimes called "investment cost") is considered as an element in valuing railroads. The original cost used is not theoretically an original cost (that is, the cost incurred when first acquired for railroad purposes), but an original cost valuation made by the Interstate Commerce Commission.<sup>25</sup> The committee on Unit Valuation of the National

Association of Tax Administrators in 1954 was clearly of the opinion that original cost offers little help in determining the market value of railroads (original cost is not used to estimate the rate base, and the conditions of the railroad industry would indicate that market value of carrier investment is less than original cost).<sup>26</sup> On the other hand, Oregon, a State which usually has a good reason for using an element, uses I.C.C. original cost less depreciation, with an additional consideration for obsolescence together with earnings and stock and debt, where available, on the theory that, by having a property factor, some stability in railroad assessments is contributed.<sup>27</sup>

*Reproduction cost less depreciation.* The hue and cry against using or giving much weight to reproduction cost less depreciation—the cost of duplicating system property at current price levels—in valuing railroad property has been growing in intensity in the last few decades.<sup>28</sup> A usual reason

<sup>23</sup> *NATA Committee on Unit Valuation Report, op. cit.*, p. 54. Cf., however Gronouski, *op. cit.*, pp. 209–211.

<sup>24</sup> D. M. Fisher, "What's Behind 'Utility' Valuations," Oregon State Tax Commission Review (1959) p. 15. See also *Chicago, Burlington & Quincy R. Co. v. State Board* and cases following it, 170 Neb. 77, 101 N.W. 2d 856 (1960) showing that Nebraska gives one-third weight to investment less depreciation. A summary of indexes of value appearing in app. 12, *California Committee on Assessment Practices 1959 Report, op. cit.*, p. 279, lists eight States as using depreciated historical cost for railroads.

<sup>25</sup> Recent discussions are: U.S. Congress, Senate Committee on Interstate and Foreign Commerce, *National Transportation Policy*, Preliminary Draft of Report, Special Study Group on Transportation Policies in the United States, 87th Cong., 1st Sess., Washington: 1961, pp. 456, 478–481 (hereafter referred to as "Doyle Report"); *NATA Committee on Unit Valuation Report, op. cit.*, pp. 54–59; Gronouski, *op. cit.*, pp. 218–232; C. M. Chapman, *California Committee on Assessment Practices 1959 Report, op. cit.*, pp. 249–254; Broley E. Travis, *Colorado Legislative Council Report, op. cit.*, pp. 59–62; James W. Martin, "Marshalling the Evidence of the Value of Public Utility Property," *Proceedings, National Tax Association, 1955*, p. 111, and "Obsolescence and the Assessment of Public Service Properties," *Proceedings, National Tax Association, 1960*, p. 410.

<sup>26</sup> Hutson, *op. cit.*

<sup>27</sup> See *State Tax Commission v. Consumer's Heating Co.*, 294 P. 2d 687 (Oregon, 1955) which shows an instance in which different depreciations were used for taxation and rate base.

<sup>28</sup> Of what this consists is set out in detail in *NATA Committee on Unit Valuation Report, op. cit.*, pp. 50–54; Gronouski, *op. cit.*, pp. 200–204.



given is that the economic conditions prevailing today in the railroad industry are such that large portions of railroad property would not be reproduced and that this gross under-utilization results in tremendous amounts of economic obsolescence which are almost impossible to measure as such.<sup>29</sup> A practical reason, at least so far as railroads are concerned, is that a reproduction costs value is today substantially higher than values based on earnings or stocks and debt.<sup>30</sup> Another reason given is that the reproduction cost usually used for railroads is derived from the data compiled by the Interstate Commerce Commission under the Valuation Act of 1913.<sup>31</sup>

<sup>29</sup> James W. Martin was recently of the opinion that, in view of the present economic obsolescence of rail property and of variations in extent of obsolescence among rail systems, use of cost data (1) tends in nearly all cases to overstate railroad values, and (2) produces enormous discrimination among individual rail systems. ("Obsolescence and the Assessment of Public Service Properties," *op. cit.*, p. 418.)

<sup>30</sup> The Doyle Report actually states: "Despite the inferior quality of cost as evidence of value one of the reasons it remains in use is that cost is usually a higher figure for railroads than current cash value and the temptation to use cost figures on railroads is sometimes influenced by a desire to justify a higher full value which will in turn appear to produce a lower equalized assessment ratio." (*Doyle Report, op. cit.*, pp. 456-457.) Reproduction cost less depreciation values recently used in some States are much higher. Some comparisons taken from recent cases are:

(1) *Chicago, Burlington & Q. R. Co. v. Dept. of Revenue*, 161 N.E. 2d 838 (Ill. 1959): Value based on average of:

	Million
Capitalized earnings.....	\$152
Stock and debt.....	135
Reproduction cost less depreciation.....	298

(2) *St. Louis-San Fran. Ry. Co. v. Arkansas Public Service Commission*, 227 Ark. 1066, 304 S.W. 2d 297 (1957): Value based on average of:

	Million
Capitalized earnings.....	\$278
Stock and debt.....	250
Reproduction cost less depreciation.....	485

<sup>31</sup> The cost to a State of making each year an estimate of the cost of reproducing railroad property would be enormous: "Any method available is less expensive than

A reproduction cost estimated in this way, the critics say, is to some extent unreliable.<sup>32</sup> Another related criticism made against relying on a reproduction cost estimate is that it is very subjective, and in the opinion of one administrator: "It must be viewed with much less confidence than is accorded historical cost less depreciation."<sup>33</sup>

The vice, however, apparently is not so much the use of a reproduction cost element based on I.C.C. data, but the use of it without allowing for economic obsolescence, which the I.C.C. apparently does not reflect in its data. The conclusion, for instance, of the NATA Committee was that reproduction cost should be included in the family of value evidences in determining the market value of railroad property but that extreme care should be used where there is obviously a large amount of obsolescence, since there is no precise way of measuring it.<sup>34</sup>

Some States, notably California, no long-

the reproduction cost appraisal." James W. Martin, *Taxation of Public Service Corporations in Virginia, op. cit.*, p. 40. Apparently several States do make their own estimates. *Carrier Taxation, op. cit.*, p. 178.

<sup>32</sup> *NATA Committee on Unit Valuation Report, op. cit.*, pp. 54-55; James W. Martin, *op. cit.*, p. 40, who said with respect to the I.C.C. valuation project, "that undertaking has been confidentially referred to by participants as 'too inaccurate to be used for any purpose'." More disturbing to C. M. Chapman was the fact that the staff of the I.C.C. Bureau of Accounts has recently been drastically reduced "with the result that the data being processed at the present time cannot be considered as authentic as it was a decade ago." C. M. Chapman, *California Committee on Assessment Practices 1959 Report, op. cit.*, p. 253. See also criticism by court of price indexing which is used for I.C.C. valuations. *Mobile & O.R. Co. v. Schnipper*, 31 F. 2d 587, 592 (D.C.E.D. Ill. 1929).

<sup>33</sup> *Hutson, op. cit.* At least one State (Colorado) eliminates this objection by using undepreciated book cost as its estimate of reproduction cost less depreciation. Broley Travis, *Colorado Legislative Council Report, op. cit.*, pp. 57-59.

<sup>34</sup> *NATA Committee on Unit Valuation Report, op. cit.*, pp. 57-59.

er use a cost element at all in valuing railroads. Others (at least Michigan, Oregon, and Wisconsin) use some element of cost, primarily to accord stability, but usually after making an allowance for economic obsolescence.<sup>37</sup> Many other States appear to be not only using a reproduction cost without economic depreciation, but also giving considerable weight to this cost.<sup>38</sup> The use of reproduction cost without giving a significant allowance for economic obsolescence for valuing railroads has long been sustained in the courts, both Federal and State, and currently courts continue to sustain the use on the basis of the established precedents. However, in the light of the present condition of many railroads, the continued use by many States without any regard for obsolescence only casts suspicion on the unit method of assessment, and increases the possibility of Federal interference for policy reasons (i.e., maintenance of a sound rail transportation system).

#### *Capitalization of Earnings*

Capitalization of earnings is the one evidence of value upon which most States making unit assessments rely heavily in valuing

practically every utility system.<sup>37</sup> The reason is partially a practical one—reliable earnings information is available for almost every regulated utility. But more important, the relevancy of capitalized earnings to market value cannot be disputed—"the result of the perfect (but impossible) capitalized earnings computation is market value."<sup>38</sup> The theory is that a property is worth what it will earn; the problem becomes one of translating anticipated future income into present capital value. This involves foreseeing future monetary returns and evaluating the extent to which possible purchasers would place a value on future returns.

The trouble with this approach to value is its subjectivity. One tax administrator concludes that: "Because of its basic importance it certainly deserves great consideration, but because of the many possibilities for going astray in its computation, it should be treated circumspectly."<sup>39</sup> The subjectivity becomes more apparent with a description of how a capitalized earnings value is computed and of determinations necessary for the computations.

To estimate what a purchaser would pay for future income, some figure representing anticipated future income is divided by the interest rate a prospective purchaser wants to earn on his money. Thus, first the antici-

<sup>37</sup> Michigan measures obsolescence by a traffic density formula on a State basis only. Gronouski, *op. cit.*, pp. 228-229. Wisconsin adjusts reproduction cost for obsolescence on a system basis by comparing earnings and efficiency tests of Wisconsin carriers with such tests of standard carriers (selected carriers with excellent earnings records). G. M. Chapman, who describes the Wisconsin method, says: "Even with this type of adjustment, the Wisconsin authorities recognize that it is far inferior as a valid evidence of value than the other two evidences." *California Committee on Assessment Practices Report, op. cit.*, p. 253.

<sup>38</sup> One-third weight for a reproduction cost, unadjusted for economic obsolescence, which was given in the Illinois and Arkansas cases cited in footnote 21, hardly seems justified even if the purpose is to give stability and prevent fluctuations which can occur in a railroad's market value over a very short period of time.

<sup>39</sup> A recent summary shows at least 23 States use this index of value for railroads, 19 States for electric, gas and telephone utilities. *California Committee on Assessment Practices 1959 Report, op. cit.*, app. 12, p. 279.

<sup>40</sup> Hutson, *op. cit.*

<sup>41</sup> Hutson, *op. cit.* George W. Mitchell is in agreement when he says: "Generally, earnings capitalization is backward looking, the rates of capitalization are far too infrequently modified and diversified. In practice, it is a valuation process that tends to become highly subjective or arbitrary." "Stock and Debt Valuations," *Revenue Administration—1961*, p. 61, Conference of National Association of Tax Administrators (Federation of Tax Administrators, Chicago, 1961).

pated income which is to be capitalized must be selected, and second, the capitalization or interest rate a purchaser would require must be found.

*Income base.* The income base should ideally be the anticipated future income. The start, however, must be today's income derived from the property being appraised—normally, income from operating property. This is usually obtainable from utility and railroad accounts kept in accordance with the accounting procedures of regulatory agencies. Adjustments will ordinarily have to be made so that the net income reasonably reflects the net results of operation. The degree to which this can be done depends to some extent on the number and training of the staff. There was until very recently little disagreement on most of the adjustments which should be made, as for example, on the treatment of taxes (other than income taxes) and depreciation.<sup>40</sup> James W. Martin, however, is of the opinion that operating revenues (gross receipts) can often be used for the income base either as a supplement to or in lieu of the use of net figures.<sup>41</sup>

<sup>40</sup> The usual adjustments are described in *NATA Committee on Unit Valuation Report, op. cit.*, pp. 25-27, apps. B-6, B-11, and Gronouski, *op. cit.*, pp. 60-68 (railroads only). The committee as well as others recommend that depreciation not be deducted from income but that remaining life be estimated and a percentage derived from a sinking fund annuity table be added to the capitalization rate. Broley E. Travis, *Colorado Legislative Council Report, op. cit.*, p. 48; C. M. Chapman, *California Committee on Assessment Practices 1959 Report, op. cit.*, p. 239; Ronald B. Welch, "Refinements in the Capitalization-of-Earnings Approach to Valuation of Public Utility Properties," *Proceedings, National Tax Association, 1955*, p. 100. Welch would also not deduct property taxes from the base, would add a property tax factor to the rate.

<sup>41</sup> James W. Martin, "Deriving a Capitalization Rate by Statistical Analysis: A Progress Report," *Proceedings, National Tax Association, 1953*, pp. 426-427, and "Obsolescence and the Assessment of Public Service Properties," *op. cit.*, p. 416. In the last article, written in 1960, he

For some years, whether income taxes should be deducted has been debated at length by the theorists.<sup>42</sup> The argument against deduction is that the amount of tax paid by a particular utility depends on variations in ownership, capitalization and accounting policies of the regulatory agency, none of which are relevant to the basic value of the underlying assets of the utility.<sup>43</sup> On the other hand, many are of the opinion that income taxes should be deducted, or, if not, an income tax component should be added to the basic capitalization rate; in no event should income before taxes be capitalized, as is being done in at least one State, unless the component is added.<sup>44</sup> California, for instance, has been adding a component to the rate since 1953.<sup>45</sup> However, most States at present do not have an adequate staff to make the involved calculations that are required under the California formula.<sup>46</sup> Even when the California formula cannot be used, adjustments should be made so that

concluded that under recent conditions in the railroad industry, the use of gross receipts is more reliable than net railway operating income either with or without income taxes.

<sup>42</sup> See, for example, lack of agreement among committee members, *NATA Committee on Unit Valuation Report, op. cit.*, pp. 27-28. See also app. B-12 showing the effect capital structure of a utility can have on income taxes.

<sup>43</sup> Gronouski discusses in detail reasons why net income after taxes of railroads is not an indicator of earnings potential. Gronouski, *op. cit.*, pp. 68-79.

<sup>44</sup> The Arkansas Supreme Court approved the use of net operating income before deduction of income taxes capitalized at 6 percent in *St. Louis-San Fran. Ry. Co. v. Arkansas Public Service Com.*, 227 Ark. 1066, 304 S.W. 2d 279, 301-302 (1957), saying, among other things: "Deduction of income tax is not an aid in determining 'Capitalized Earnings Value' because the invested capital has made an earning regardless of the income tax rate." Reasons why income taxes should be deducted if a component is not added are succinctly stated and illustrated by C. M. Chapman, *California Committee on Assessment Practices 1959 Report, op. cit.*, pp. 198-200.

<sup>45</sup> The formula used by California is set out in app. 10, *California Committee on Assessment Practices 1959 Report, op. cit.*, pp. 276-277.

<sup>46</sup> *Ibid.*, p. 240.

the income tax accruals for a given year reflect the actual tax liability against operating income for that year.<sup>47</sup>

The court cases decided over the last 50 years indicate that in general most States have been averaging the yearly income of the utility for a period of prior years, usually 3 or 5, to arrive at the income base which will be capitalized.<sup>48</sup> The assigned reason is to level peaks and valleys, but, as C. M. Chapman has remarked, "there is no magic in a 3-or 5-year average."<sup>49</sup> The current viewpoint is that the number of years which should be used is a matter of judgment and can vary among utilities or types of utilities, and that generally a short-term average is more likely to reflect a realistic forecast than a long one.<sup>50</sup> It has further been recommended that where a 5-year average is employed, the earlier years be given less weight than the later.<sup>51</sup> Some factors considered to be determinative of the number of years which should be used are: the history of the earnings fluctuations of the particular utility or type of utility, whether the industry is rapidly

growing and changing economic conditions and price levels.<sup>52</sup>

*Derivation of basic capitalization rate.* The most difficult thing to determine in capitalizing earnings is the basic rate of capitalization. Within the last 10 years some research on objective methods for ascertaining the rate has been done. The results of this work suggest that methods can be developed to establish capitalization rates which are neither "manufactured out of thin air,"<sup>53</sup> nor roughly calculated on the basis of a "pure" interest rate combined with an estimated risk rate.<sup>54</sup> More important, however, the studies demonstrate that the rate for the various utility industries is not necessarily the 6 percent rate traditionally used by most central-assessing States.<sup>55</sup>

<sup>47</sup> Thus, in the electric, gas, and telephone industries, which are rapidly increasing their plant, a 1-year figure is recommended as more representative of future income prospects, "unless the earnings of prior years are adjusted upward to reflect increase in utility plant." Chapman, *California Committee on Assessment Practices 1959 Report*, *op. cit.*, p. 238. Cf. Ellis, *op. cit.* Too, immediately following World War II, little reliance could be placed on wartime earnings of railroads. Gronouski, *op. cit.*, p. 59.

<sup>48</sup> Ronald B. Welch, "Refinements in the Capitalization-of-Earnings Approach to Valuation of Public Utility Properties," *Proceedings*, National Tax Association, 1955, p. 106. Welch described the "thin air" as "the raw material out of which capitalization rates are commonly fabricated."

<sup>49</sup> The "pure" interest rate is usually assumed to be the market yield on U.S. Government securities. Dean Ellis was of the opinion in 1960 that the rate on Government securities no longer represented pure interest. Ellis, *op. cit.*, p. 393.

<sup>50</sup> The summary appearing in *California Committee on Assessment Practices 1959 Report* (p. 279) shows that a 6 percent rate was used by 17 out of 23 States for railroads, by 13 out of 18 States for electric and telephone companies, and by 15 out of 18 States for gas companies. See comment of C. M. Chapman, *ibid.*, p. 240: "All too often a central assessing agency will employ a 6 percent basic rate without any consideration as to how it has been determined. • • • Probably the more likely reason is the fact that the assessing agency has consistently followed the practice of using 6 percent as its capitalization rate without any thought as to its origin." The Illinois Supreme Court criticized this practice in *Chicago, Burlington &*

<sup>47</sup> Procedures for making these adjustments for railroads may be found in Gronouski, *op. cit.*, pp. 83-90 and *NATA Committee on Unit Valuation Report*, *op. cit.*, apps. B-9-B-11.

<sup>48</sup> The summary of assessment methods in other States appearing in app. 12 to C. M. Chapman's *California Report, 1959* (p. 279) shows that at least 19 States at that time used a 5-year average for railroads and 12 States used a 3-year average for electric, gas, and telephone utilities.

<sup>49</sup> C. M. Chapman, "Property Taxation of Railroad Property," *op. cit.*, p. 252.

<sup>50</sup> *NATA Committee on Unit Valuation*, *op. cit.*, pp. 23-25. In Oregon, the starting point is the actual return of the operating plant for the year immediately preceding the tax year but the rate is based on a projected anticipated future income. See explanation, Dean Ellis, "Problems in the Use of Stock and Debt and Income Factors in the Assessment of Telephone and Electric Utilities," *Proceedings*, National Tax Association, 1960, p. 390.

<sup>51</sup> *NATA Committee on Unit Valuation Report*, *op. cit.*, p. 25. Gronouski does not entirely agree. Gronouski, *op. cit.*, p. 58.

The rates found in each of the studies were based on a comparison of earnings with the market value of securities for the various types of utilities and transportation companies. Two different approaches were used. Under one, the total income available for all securities was compared with the total market value of the securities. Thus, in one of the first of these studies, James C. Kenady compared the income available for fixed charges (including income from non-operating property) of 15 railroads from 1948 through 1952 to the market value of the securities of those railroads for these years.<sup>56</sup> The same approach was used in the study undertaken by the Bureau of Business Research, University of Kentucky, under the supervision of James W. Martin.<sup>57</sup> Rates were found for nine classes of public service corporations by comparing total earnings and total market value. Instead of basing the rate for each class on net income available for fixed charges (as Kenady had done), three rates based on different income concepts were found for each class. The earnings for the numerators were (a) net

operating income, (b) net operating income plus income taxes, and (c) gross receipts from the utility or railroad business. The denominator in each case was security market value.<sup>58</sup> The reliability of each rate was tested statistically, and weights were suggested for a composite average capitalized earnings.

Under the other approach, a separate rate is computed for each of the various types of securities, and these rates are combined to obtain an overall rate. The study of the National Association of Tax Administrators, for the most part done by John A. Gronouski, employed this method in finding a rate for railroads and for electric utilities.<sup>59</sup> Security market values for the year 1951 and income data for the years 1949-51 of 36 railroads and 108 electric utilities were used.<sup>60</sup> Criticism of this study has concentrated primarily on the assumptions made and procedures followed in computing the common stock rate.<sup>61</sup> This rate was not a simple earnings available for dividends/market value of common stock ratio; it was an adjusted rate termed a "dividend rate of capitalization"—a ratio of dividends to that part of common stock price dependent upon dividends—derived by use of a statistical device. It was assumed that the

*Q.R. Co. v. Dept. of Rev.*, 161 N.E. 2d 838 (Ill. 1959). The State agency defended its use of 6 percent on the ground that this rate had been uniformly applied to all railroads for 26 years during periods of depression and inflation. The court, after stating that it was "troubled by the inadequacy of this explanation" (p. 843), remanded the proceedings to the State agency for the determination of a proper rate.

<sup>56</sup> James C. Kenady, "A Fair Rate for Capitalization of Earnings," *Proceedings*, National Tax Association, 1953, p. 417. The average rate of capitalization produced was 8.21 percent, which Mr. Kenady thought too low because "the nonoperating income is more certain, has less of the risk factor than the strictly operating income."

<sup>57</sup> The first results, together with a summary of the method, were published in 1954. James W. Martin, "New Evidence on Tax Valuation of Public Service Property—Capitalization of Earnings," *National Tax Journal*, vol. VII, pp. 309-318. Many other articles have appeared, the most recent of which, James W. Martin, "Obsolescence and the Assessment of Public Service Properties," *op. cit.* (1960), contains the findings regarding railroads based on 1955, 1956, and 1957 data.

<sup>58</sup> For example, the three rates for railroads based on 1952 data and the years immediately preceding were (a) 6.7 percent, (b) 11.2 percent and (c) 62 percent.

<sup>59</sup> In 1954, the results were published in ch. 8 and app. C of *NATA Committee on Unit Valuation Report*, *op. cit.* A more detailed version of the work appears in John A. Gronouski's doctoral dissertation, "Valuation of Railroads for Ad Valorem Tax Purposes," *op. cit.*, p. 93.

<sup>60</sup> The average rates found were 5.75 for railroads and 4.62 for electric companies.

<sup>61</sup> C. Blair Hutson, "Objectivity in the Derivation of a Rate of Capitalization," paper presented at 1958 Conference of National Association of Tax Administrators; Ferry B. Allen, "Derivation of a Rate of Capitalization for Ad Valorem Tax Purposes—Public Utilities," paper presented to 1960 Conference of National Association of Tax Administrators; Dean Ellis, *op. cit.*

ordinary buyer of common stock, when appraising a security, gives far greater weight to dividends than to retained earnings. However, several critics question whether this assumption is still valid.<sup>42</sup> Probably because of the controversial treatment of the common stock rate, the NATA method has apparently not been used by any tax administrator.<sup>43</sup>

Since the publication of these three studies, a progress report on research based in part on these studies by the staff of the valuation division of the Oregon State Tax Commission has been presented by Donald M. Fisher.<sup>44</sup> The Oregon Tax Commission has used three separate methods to develop yearly rates since 1951 for five industry classes (electric, gas, telephone, airlines, and railroads). Two of these methods—the NATA method and the Kenady method—have been described. The third method, called “costs of capital” method, was developed by the Commission. This method employs the NATA approach—a rate is found for each type of security of the capital structure for each company in the class. But unlike the NATA method, the rate for the common stock is derived from the ratio of annual per share earnings to the market price for the stock. Furthermore, the rate for each type of security is weighted according to the market value of the type rather than according to the capitalized value of income attributable to each type, as is done under the NATA method. Donald Fisher believes that of the three methods the “cost of capital” method produces the superior result.<sup>45</sup> The advantage over the Kenady

method, he says, is that the breakdown of the capital structure into segments tells more about what is being done, which “is necessary if we are to understand the derivation of the statistical results, or be able to recognize the pitfalls and opportunities that exist for judging their relative merits and reliability.” The notable difference between the NATA method and the “cost of capital” method is the omission of a dividend rate of capitalization for common stock. The report also stresses that the general approach advocated differs in two respects from the NATA approach: first, evidence of rates is sought from long-term trends rather than from the particular computation for a single year, and second, comparable procedures for each industry class were followed with the aim of obtaining reliable data on risk differences between industries.<sup>46</sup>

The report concludes that the statistics clearly show different industries to be entitled to different capitalization rates, but that judgment as well as statistical tools are needed for the development of a capitalization rate.

The four described studies develop a capitalization rate for major classes of utilities rather than a different capitalization rate for each company within each class. This capitalization rate should be applied to the in-

<sup>46</sup> The pattern reflected by the rates derived from each of the three methods (Kenady, NATA and cost of capital) for the years 1951 through 1959 do indeed show marked differences among industries. The 5-year averages (1955-59) were:

	Kenady	NATA	Cost of capital
Electric.....	5.1	5.0	5.4
Gas.....	5.6	5.4	5.8
Telephone.....	5.4	5.3	6.1
Airlines.....	5.5	8.7	6.1
Railroads.....	7.2	5.4	7.5

<sup>42</sup> Allen, *op. cit.*; Ellis, *op. cit.*

<sup>43</sup> Ellis, *op. cit.*

<sup>44</sup> Donald M. Fisher, “Capitalization Rates for Centrally Assessed Companies,” paper presented at 29th Conference, National Association of Tax Administrators, June 1961.

<sup>45</sup> *Ibid.*, p. 6 of mimeographed copy.

come base derived for each company. It is most important, however, that the income concepts used, on the one hand, for the capitalization rate and, on the other hand, for the income base, be the same. For example, if gross receipts are used as the income base, as Martin recommends in some cases, the capitalization rate should have been derived from the ratio of gross receipts to market value of securities.

The studies of capitalization rates developed rates for classes, not individual companies. It is generally recognized that rates for individual companies are preferable.<sup>67</sup>

### *Stock and Debt Value*

Under the stock and debt method of valuation, the market value of the securities listed on the liability side of the balance sheet is ascertained. The theory is that since total assets on a balance sheet equal total liabilities, the market value of the liabilities is the market value of properties represented on the asset side of the sheet.

Although the stock and debt value approach was the first utilized by the States in making unit assessments,<sup>68</sup> today it is not as generally used as the capitalized earnings approach.<sup>69</sup> The principal reason for the more limited use of stock and debt value is the absence of a market for the securities of some utilities, e.g., where a utility is wholly owned by another corporation or where a

substantial part of its securities is closely held.<sup>70</sup>

To find a stock and debt value, the appraiser first prices each type of security, i.e., the stocks and bonds, by using market quotations. There has been considerable controversy over the time which should be chosen for ascertaining the prices of the securities. A summary published in 1959 shows that 13 States used a 5-year average, 3 used 3 years, 8 used 1 year and 2 used 1 day.<sup>71</sup> The traditional reason for using 3 or 5 years is, as with earnings to be capitalized, to level out ups and downs which do not represent real changes in value. The current view, however, favors a much shorter period, at most 1 year, on the grounds that the current market prices reflect the present value judgments of investors, which is the aim of the valuation, and that the capital structure of most utilities changes over a longer period of time.<sup>72</sup>

<sup>67</sup> The NATA Committee on Unit Valuation concluded that stock and debt value was appropriate only for larger class I line railroads and a relatively few of the larger utilities which serve heavily populated areas. *NATA Committee on Unit Valuation Report, op. cit.*, p. 37. George W. Mitchell (who believes that stock and debt is to be preferred over capitalized earnings) suggested recently the possibility of constructing market quotations for unquoted securities from the known facts of similarly circumstanced properties by using electronic equipment capable of handling large numbers of variables. "Stock and Debt Valuations," *op. cit.*, p. 61. He also says that the greatest deterrent to use of stock and debt value is that it appears too low for railroads and too high for many other utilities (p. 62).

<sup>68</sup> See footnote 69.

<sup>69</sup> NATA Committee on Unit Valuation, *op. cit.*, pp. 38-39; Ellis, *op. cit.* (who discusses the uninformed investor in today's market); Chapman, *California Committee on Assessment Practices 1959, op. cit.*, pp. 244-245; Travis, *Colorado Legislative Council Report (1959), op. cit.*, pp. 54-55; Gronouski, "Refinements in the Use of the Stock and Debt Approach to Value," *Proceedings, National Tax Association, 1955*, pp. 88-90 (he suggests a 6-months period). Even as late as 1947, James W. Martin was of the opinion that a period of around 5 years is usually appropriate. *Taxation of Public Service Corporations in Virginia, op. cit.*, p. 44.

<sup>67</sup> Chapman, *California Committee on Assessment Practices 1959 Report, op. cit.*, p. 86; Ellis, *op. cit.*; Travis, *Colorado Legislative Council Report, op. cit.*, p. 52.

<sup>68</sup> See early Federal cases, *State Railroad Tax Cases*, 92 U.S. 575 (1875); *Pittsburgh, C. C. & St. L. R. Co. v. Backus*, 154 U.S. 421 (1894); *Cleveland, C. C. & St. L. R. Co. v. Backus*, 154 U.S. 439 (1894).

<sup>69</sup> The summary of assessment methods in other States appearing in app. 12, *California Committee on Assessment Practices 1959, op. cit.*, p. 279, shows 20 States used stock and debt for railroads and 14 States used it for electric, gas, and telephone utilities while 23 used capitalized earnings for railroads and 19 for the other utilities.

Even 1 day—"spot" prices on assessment day—has been advocated on the ground that objectivity, which the advocate believes is one of the virtues of the stock-and-debt approach, is lessened by averaging over any period.<sup>73</sup>

Stocks and debt represent long term liabilities. But short term obligations also appear as a liability on the balance sheet. For years, in the courts and on the rostrum, the question was debated whether current and deferred liabilities should be included. Today, apparently the resistance by utilities to their inclusion in the value is lessening.<sup>74</sup>

The value of all the securities of the utility, including short-term obligations, represents the value of all the assets belonging to the utility. Some of these assets are exempt from taxation, or, if taxable, are not taxable as part of the unit. The most difficult administrative task is the elimination of value attributable to these assets from the stock and debt value which will be used. The major deduction is nonoperating property. Two methods may be used to value this property for exclusion, neither of

which is considered completely satisfactory.<sup>75</sup> Under one, an independent appraisal may be made of the nonoperating property by using other evidences (such as capitalized earnings and cost). Under the other, a part of the stock and debt value is allocated to nonoperating property by the ratio of net income from nonoperating to the total net income for the utility.<sup>76</sup>

Stock and debt value, like other evidence, has its strong and weak points. The overwhelming consensus of opinion is that where market quotations can be established for most of the capital structure, and where the exclusions which must be made from the value are small, stock and debt value is an acceptable evidence of value and is more objective than capitalized earnings. Some of its other virtues are that it represents the collective judgment of market analysts and of those who "stake their money on their predictions"<sup>77</sup> of the prospective future earnings of the utility rather than representing the judgment of one appraiser; that it eliminates many analytical decisions necessitated in finding a capitalized earnings value (i.e., general prospects of the economy, of the particular industry, and of the particular utility, the problems involved in finding a capitalization rate, and capitalization before or after income taxes);<sup>78</sup>

<sup>73</sup> C. Blair Hutson, "Weighting the Evidences of Value in the Determination of a System Value," *op. cit.* Gronouski doubts the advisability of using 1 day because of possible influence of speculators. *op. cit.*, p. 89. In a letter of June 10, 1963, to ACIR, Mr. Hutson said, however, "I have been extremely bothered by the recent high sales prices of utility common stocks. . . . when the appraiser finds equity capital commanding a smaller rate of return than bond rates, as he sometimes does, he is shaken. He feels the stock buyer must be buying something only very distantly related to the earning power and the value of the utility property."

<sup>74</sup> *NATA Committee on Unit Valuation Report, op. cit.*, pp. 39-42; Martin, *Taxation of Public Service Corporations in Virginia, op. cit.*, p. 44, Gronouski, *op. cit.*, p. 90; *Carrier Taxation, op. cit.*, p. 106. Ellis, *op. cit.*, stated in 1960 that for 2 years no utility had questioned the validity of the inclusion of short term liabilities in Oregon. Ellis also discusses whether income tax reserve accounts of some utilities (particularly electrical) for deferred income taxes resulting from "fast write-offs" under special income tax provisions is "debt." He concludes it should be treated as debt.

<sup>75</sup> See discussion, *NATA Committee on Unit Valuation Report, op. cit.*, pp. 42-44.

<sup>76</sup> The latter method assumes that purchasers of securities give equal weight to operative and nonoperative income and that they base their purchase price on earnings. Travis, "Appraisal of Public Utility Property," *op. cit.* C. M. Chapman mentions a third method which is sometimes used: the acceptance without question of values submitted by the utility, which are usually book values. The impropriety of this is obvious. Chapman, Comments on paper of Gronouski, *op. cit.*, footnote 61, *Proceedings, National Tax Association, 1955*, p. 121.

<sup>77</sup> *Carrier Taxation, op. cit.*, p. 109.

<sup>78</sup> George W. Mitchell, "Stock and Debt Valuations," *op. cit.*, pp. 61-62.



and finally, that it takes into account "myriads of external factors that determine asset values," including the important subjective one of "what people think."<sup>79</sup>

Shortcomings often brought up are that it cannot be used for all utilities, that it sometimes reflects influences which have nothing to do with value (speculation, uninformed investors, interest and dividend policies), that market prices ignore the value of control,<sup>80</sup> and that netting out the value of nonoperating property makes the value as subjective as capitalized earnings.

The overall opinion of those cited, who for the most part are tax administrators, is that a stock and debt value, where available, is an essential element of value. At least one author thinks that "the absolute levels of railroad and utility valuations should be at, or trending toward the stock and debt value."<sup>81</sup> The general view is that it is one of the more objective measures of value available for use and that the weight given this evidence should depend upon the evaluation made of this value and of the data upon which it is founded, together with its relative validity as compared to all the other evidences of value.

#### *Evaluating the Evidences*

As noted earlier, there is no standard formula for determining the market value of a railroad or other public utility system. The various direct evidences of value which

have been outlined above are highly useful tools for the assessor in making his appraisals, but only in providing relevant data to aid him in objective analysis of the value of each system. No one such evidence can be relied on exclusively in estimating the value of a complex utility system, and, as C. M. Chapman says, "The tools with which an assessor works (the value evidences) are not sufficiently error-proof to warrant implicit reliance on any mathematical averages of value evidences."

The final valuation of each unit must depend on the assessor's judgment, but it must be a judgment backed by the assembly and study of all the evidences of value that are pertinent to the market value of the particular utility property under appraisal. He has the task of analyzing each type of evidence, weighing the applicability of evidence that fails to agree on value, and determining the types of evidence to be used or rejected either for whole categories of utilities or for a particular utility. Supplementing the formula-type evidence available, the assessor also needs to fortify his judgment by accumulating such factual information on each utility in his jurisdiction as the nature of its service area and its operating and financial outlook.<sup>82</sup>

### INTERSTATE ALLOCATION

Most railroads and airlines, and many other large utilities, operate in more than one State. Where this is so, the assessing State must determine the portion of the system value allocable to that State. To do

<sup>79</sup> *NATA Committee on Unit Valuation Report, op. cit.*, p. 47.

<sup>80</sup> Gronouski discusses this in detail and concludes that the appraiser must recognize that market value of common stock will generally understate the value by an amount equal to value associated with control and that there is no way of placing a dollar value on corporate control. *op. cit.*, pp. 92-95.

<sup>81</sup> Mitchell, *op. cit.*, pp. 62-63.

<sup>82</sup> For pertinent conclusions on resolving the evidences of value, see Chapman, *California Committee on Assessment Practices 1939 Report, op. cit.*, pp. 254-257, and Travis, *Colorado Legislative Council Report, op. cit.*, p. xiv.

this, the State uses allocation factors appropriate for the type of utility being assessed. The objective in choosing these factors for a particular system should be an allocation of value totaling 100 percent, no more and no less, for all States involved, which at the same time gives each State its fair share of the total value. The ideal, then, would be the use of a uniform allocation formula in all States in which a utility has taxable property, and this formula should apportion as nearly as possible a proper share of the value to each of these States.

Attainment of the ideal is theoretically impossible. Breaking up a unit value into segments is an arbitrary process since the segments do not have the same value as they have as part of an integrated system. However, the process is less arbitrary when the factors used for allocation reflect the amount, use, and value of property.

Allocation practices of most States have fallen far short of the ideal; the choice of factors often depends upon the relative advantage to the assessing State. The use of particular factors which will import disproportionate values is limited to some extent by the Federal Constitution. An allocation which results in taxing property outside the State violates the interstate commerce or due process clauses of the Constitution;<sup>83</sup> but considerable violation appears to exist.

<sup>83</sup> E.g., in *Wallace v. Hines*, 253 U.S. 66 (1920), a North Dakota excise tax measured by railroad system value apportioned by main-line track miles was held to tax property outside the State. Justice Holmes pointed out the injustice of assuming the value to be evenly distributed according to main track mileage in an agricultural State such as North Dakota; valuable terminals were in other States. But compare *N.C. & St. L. Ry. Co. v. Browning*, 310 U.S. 362 (1940), where in apportioning to Tennessee, use of road mileage alone (which was higher than any other factor) was sustained.

For example, in 1947 the NATA Committee on Railroad Allocation thought there was probably merit in "complaints on the part of carriers that the aggregate of the allocation factors currently being used is considerably over 100 percent."<sup>84</sup>

In essence the achievement of equitable allocation demands interstate cooperation with a willingness on the part of each State to submerge self-interest for equity. The tools—fair allocation formulas—are now available. A committee of the National Association of Tax Administrators developed an allocation formula for railroads as long ago as 1947,<sup>85</sup> while the Western States Association of Tax Administrators recently proposed formulas for airlines, electric, pipeline, telephone, telegraph, and private car companies.<sup>86</sup>

The complexity of developing a fair formula and the difficulty of adoption are illustrated by the NATA railroad allocation formula (originally called "operating characteristics" method of railroad allocation). The NATA Committee first reasoned that any railroad allocation formula must include factors reflecting the two functions of transportation services—the "terminal" (origin and destination of rail traffic) and

<sup>84</sup> *Preliminary Report*, Committee on Railroad Allocation, National Association of Tax Administrators (Chicago 1947), p. 2 (hereafter cited as "NATA Committee on Railroad Allocation Report"). The Doyle Report, *op. cit.*, issued in 1961, contained a similar opinion (p. 482).

<sup>85</sup> *NATA Committee on Railroad Allocation Report*, *op. cit.* Each central-assessing State had a representative on the committee. Subsequently, a subcommittee recommended a few changes, which were reported in *Revenue Administration—1949*, pp. 59–63, Conference of National Association of Tax Administrators (Federation of Tax Administrators, Chicago, 1949).

<sup>86</sup> *Report*, Committee on Allocation of Public Utilities, Western States Association of Tax Administrators (1960) (hereafter cited as "WSATA Committee on Allocation Report").

the "line-haul" (actual transportation from point of origin to point of destination). The Committee also believed that a property factor should be used. Therefore, the following three factors were selected for the formula: (1) Terminal tons handled or terminal cars handled, to measure the terminal function;<sup>87</sup> (2) Revenue traffic units (ton miles and passenger miles), to measure the line-haul characteristic; and (3) I.C.C. cost of reproduction less depreciation, to measure the amount of property. The weightings of the three factors were made dependent upon the operating characteristics of each individual railroad, and these characteristics were derived from the railway operating expenses of the railroad (terminal operating expenses, line-haul operating expenses and property operating expenses).<sup>88</sup> The weightings normally are about 45 percent for the property factor, 35 percent for line-haul and 20 percent for terminal.<sup>89</sup>

Thirty-six States centrally assess railroad property; yet by 1959 only five States (Alabama, California, Oregon, Washington, and Wisconsin) used the NATA formula.<sup>90</sup> Resistance to the NATA formula has been attributed to the fact that "bridge" States (States where railroads are predominantly line-haul) have been using allocation factors (such as track mileage) which do not reflect terminal characteristics. Use of the

NATA formula would give them a smaller percentage of total system value.<sup>91</sup>

Since the appearance of the WSATA report, insufficient time has elapsed to judge whether the same type of resistance to its formulas for the major categories of utilities will be encountered. The WSATA report, in addition to suggesting formulas for the six types of utilities, states five principles basic to development of the formulas. These are: (1) allocation for all States should total 100 percent, not more, not less; (2) allocation should be of the value of existing property, not merely of the amount of physical property; (3) readily available statistics should be used; (4) an allocation factor should not be an allocation; and (5) the statistics used should reflect the quantity of property, or its use or value.

The formulas for the various classes of utilities, like the NATA formula for railroads, are generally not simple averages of

<sup>87</sup> Authorities cited footnote 89. Test appraisals of Colorado railroads made by one of them, Broley Travis, give an example. A Colorado statute directs allocation on the basis of track mileage (ratio of miles of track in Colorado to total miles of track in system). For three railroads, Travis compared the statutory factor used by the Colorado Tax Commission (all track mileage) with allocation based on the NATA formula and a six-factor formula (average of all track miles, depreciated cost, traffic units, equipment mileage, gross revenue and terminal tonnage). The results were (p. 69):

	Statute	NATA	Six-factor
	%	%	%
Atchison, Topeka & Santa Fe Ry. . . . .	4.47	3.10	2.81
Union Pacific Ry. . . . .	6.499	3.91	4.08
Denver & Rio Grande Ry. . . . .	62.99	not available	54.03

Travis recommended that the statute be amended to eliminate the specific directive to use track mileage so that a formula reflecting operating characteristics could be used. No such amendment has as yet been passed.

<sup>88</sup> This was the original proposal. In 1949, the subcommittee recommended the use of locomotive switch miles to measure terminal activity.

<sup>89</sup> The original proposal derived the weightings from operating revenues instead of operating expenses.

<sup>90</sup> Travis, *Colorado Legislative Council Report*, *op. cit.*, p. 66; Chapman, *California Committee on Assessment Practices 1959 Report*, *op. cit.*, p. 258.

<sup>91</sup> Chapman, *ibid.*, p. 258.

factors. Probably airline property presents the most difficult allocation problem, particularly with regard to mobile flight equipment.<sup>82</sup> Although every conclusion of the committee might not be satisfactory in the judgment of every appraiser, the analysis amply reveals the problems and provides the basis for fair, uniform apportionments. Briefly, the allocation procedure recommended by the committee for airlines is as follows. System terminal and mobile property are separated on an original cost basis. Terminal property in each State is appraised at situs; thus no allocation is made of this property. System mobile property (generally 65 to 75 percent of system value) is allocated by use of the following factors: (1) 75 percent weight: an equated plane-hour factor to measure the quantity of property;<sup>83</sup> (2) 20 percent weight: a revenue ton miles factor to measure the use of the property; (3) 5 percent weight: an originating and terminating tons factor to

measure the terminal characteristics. Equated plane hours must total 100 percent and may be divided or allocated to two types of jurisdiction—taxable and nontaxable. Fly-over time is considered not to be in a taxing jurisdiction because the property cannot be attached, and probably taxes levied cannot be collected. Also, fly-over time over the oceans is outside of any taxing authority.<sup>84</sup>

The allocation formulas proposed by WSATA for the other utility types are also basically a mixture of quantity and use factors, with greater weight given to the quantity factors. Although, as mentioned before, experts might disagree about the particular factors chosen and the weights suggested in the formulas, the formulas are certainly more equitable and realistic than many of those now used in central-assessing States.<sup>85</sup>

## INTRASTATE ALLOCATION

Intrastate allocation—the apportionment of the intrastate unit value among the various taxing units within the State—is, for practical reasons, far more complex than interstate allocation. On the one hand, interstate allocation usually involves the division of system values of relatively few sys-

<sup>82</sup> Apportionment is particularly important for jurisdictional reasons. In *Braniff Airways v. Nebraska State Bd. of Equalization and Assessment*, 347 U.S. 590 (1954), the Supreme Court upheld the right of a State to tax ad valorem a properly apportioned share of airline operating property used regularly in the State. The decision did not rule on the Nebraska apportionment formula (originating revenue, originating tonnage, and aircraft arrivals and departures) since the airline did not challenge it. This formula had been developed by an advisory board to the Civil Aeronautics Board and adopted by the Council of State Governments. See discussion, J. D. Durand, "Some Recent Trends and Present Problems in State Taxation of Airlines," *Proceedings*, National Tax Association, 1956, pp. 445-450. At that time he was of the opinion the proper formula should be based on the length of time aircraft are in the taxing jurisdiction. A recent Supreme Court case indicates a nondomiciliary State has jurisdiction to tax ad valorem migratory property which is habitually present, although on irregular routes. *Central Railroad Co. v. Penn.*, 82 Sup. Ct. 1297 (1962) (rolling stock of railroads).

<sup>83</sup> Plane hours (number of planes  $\times$  24 hours  $\times$  365 days) equated so as to give different weightings to different types of planes from a physical standpoint. The committee at that time believed historical cost to be the least defective equating plane hour factor.

<sup>84</sup> It was the opinion of the WSATA Allocation Committee that time or value of aircraft while outside any taxing jurisdiction should not be taxed in some other jurisdiction in which the aircraft was not situated (flying or standing).

<sup>85</sup> Allocation of telephone companies in Colorado on the basis of miles of telephone line, as required by statute, is an example. According to Broley E. Travis, "with the present plant of a telephone company, with microwave transmission and other changes in methods of communications this 'pole line' mileage is meaningless." *Colorado Legislative Council Report*, *op. cit.*, p. 70. The WSATA formula for telephone companies would consist of undepreciated historical cost (75 percent), operating revenue (15 percent) and net operating income (10 percent). *WSATA Committee on Allocation Report*, *op. cit.*, pp. 31-32.

tems among only a few States (say 8 or 10 at most in the case of a large railroad). Statistics bearing a relationship to the amount of property, its value and use are available or can be compiled. On the other hand, intrastate allocation requires the division of the values of numerous systems among various groupings and overlappings of hundreds or thousands of local taxing units.<sup>96</sup> Statistics for most factors will almost never be readily available for these tax districts; the choice of an allocation factor is usually reduced to the few for which statistics can be easily and inexpensively obtained.

Although intrastate allocations total 100 percent (control of the allocation is in the power of one State and not of many States), inequities still result to utilities or tax districts because too high or too low a value may be allocated to a tax district with a high or low tax rate. These inequities may be minimized by the method chosen for the allocation. The choice, according to one administrator, should be governed by two principles—consistency and convenience: consistency in view of objectivity and convenience in view of the large number of allocations.<sup>97</sup>

In the case of both railroads and other utilities, reproduction cost less depreciation has been suggested as the best method of allocation.<sup>98</sup> However, the expense of making reproduction cost studies would be burdensome for most States. For rail-

roads, the next best allocation method is all-track mileage weighted for traffic density. The use of main track mileage, which is required by statute in some States, causes distortions in that it fails to measure density of traffic and terminal facilities.<sup>99</sup> For other utilities, the next best allocation factor is historical cost less depreciation (particularly where the cost is the rate base).<sup>100</sup> Miles of pipe or miles of wire are poor measures of property location, since today it cannot be assumed that other property of the utilities is located in proportion to the miles of pipe or wire.

There is, then, no cure for inequities arising from intrastate allocations. This does not mean that the allocation process cannot be improved by adoption of the best (or even next best) method. Nevertheless, inequities will remain. There being no cure, the logical step is to eliminate the process, as two States (Michigan and Wisconsin) have done, and to tax centrally assessed property exclusively at the State level.<sup>101</sup> The burden of taxation borne by State assessed property can be made relatively the same as that borne by locally assessed property if an average equalized State rate is applied.<sup>102</sup> Serious problems of local finance that may arise once this source of revenue is withdrawn from the tax districts can be avoided by returning the tax proceeds to the localities or tax districts.<sup>103</sup> Naturally, problems of apportioning the proceeds

<sup>96</sup> In California, for example, this means over 5,000 taxing districts and over 16,000 code areas or tax rate areas.

<sup>97</sup> Travis, *Colorado Legislative Council Report*, *op. cit.*, p. 71.

<sup>98</sup> Travis, *ibid.*, p. 72; Martin, *Taxation of Public Service Corporations in Virginia*, *op. cit.*, p. 68; Chapman, *California Committee on Assessment Practices 1959 Report*, *op. cit.*, pp. 218-223. Chapman criticizes California allocations which are made on the basis of RCLD, for failure to use RCLD consistently.

<sup>99</sup> Travis, *op. cit.*, p. 72; Martin, *op. cit.*, p. 68.

<sup>100</sup> *Ibid.*

<sup>101</sup> Michigan does this for the operating property of railroad transportation and communication companies; Wisconsin for the operating property of railroads and most classes of other utilities.

<sup>102</sup> Wisconsin does this. See discussion in vol. 2.

<sup>103</sup> In Michigan, the proceeds are used for school purposes. In Wisconsin, 85 percent of taxes of utilities are returned to localities while railroad taxes are used for general State purposes.

will come up, but the allocation of the proceeds would be on the basis of declared State policy, rather than of the fortuity of the particular method chosen for allocating property value. There need be no pre-

tense that market value is being distributed; thus many readily available factors unrelated to market value or to the utilities can be used for equitable distribution in accordance with State policy.

## II. EQUALIZATION

When railroad and other public utility property is subject locally to the general property tax, the usual requirement is that it be taxed uniformly with other property. This means that in each taxing district it is to be assessed at the same level and taxed at the same rate as other classes of property. Often the law is specific about equalizing the taxation of utilities and other property types. A few States provide for the taxation of utility property under a classified system or at special or statewide average rates, but uniformity is a widespread requirement.<sup>104</sup>

When property subject to this uniform treatment is centrally assessed, two levels of assessment administration become responsible for maintaining a uniform level of assessment among classes of property within each local assessment district. The local assessor must equalize the levels of assessment of the classes of property for which he is responsible, while the State assessing agency must equalize its assessments with local assessments. The latter requirement has its broadest application in the instance of railroad and other public utility property, which in 1961 accounted for 89 percent of the assessed valuation of State as-

essed property;<sup>105</sup> but it applies with equal force to all classes of centrally assessed property.

### NATURE OF THE EQUALIZATION PROBLEM

The equalization problem has existed to some extent since central assessment was adopted; but in recent years it has become more serious, with utility property centrally assessed at much higher ratios of market value than locally assessed property in numerous States. No comprehensive, impartial study, with reliably supporting statistics, has been made of the level of assessment of utility property in all of these States; but sufficient evidence is at hand to indicate that large disparities do exist between the assessments of centrally assessed and locally assessed property.<sup>106</sup>

#### *Evidences of Discrimination*

For evidence of where and to what extent inequality exists, dependence must be placed primarily on a few recent reports and studies and on recent court cases involving pub-

<sup>104</sup> For treatment of utility property for property taxation by the individual States see National Association of Tax Administrators, *Appraisal of Railroad and Other Public Utility Property for Ad Valorem Tax Purposes*, Chicago, 1954, Appendix A-1. For an analysis of the uniformity provisions of State constitutions as they relate to property taxation, see Newhouse, *op. cit.*

<sup>105</sup> Of State assessed property with a total assessed valuation of \$27.8 billion in 1961, railroads accounted for \$5.9 billion and other utilities for \$18.8 billion. (U.S. Bureau of the Census, *Assessed Values for Property Taxation*, 1962 Census of Governments, Preliminary Report No. 5.)

<sup>106</sup> The National Association of Tax Administrators' Committee on *Ad Valorem Taxation of Railroads and Public Utilities* is studying discrimination in the assessment of public utility property as against other types of property. What statistical studies the committee plans to make is not known.

lic utility assessments. With respect to railroad property, the Doyle Report, produced in 1961 by a special study group on transportation policy for the Senate Committee on Interstate and Foreign Commerce, declared that there "is a studied and deliberate practice of assessing railroad property at a proportion of full value substantially higher than other property subject to the same tax rates."<sup>107</sup> No comprehensive data on the level of public utility assessments were gathered by the study group; the finding relied primarily on a table submitted by the Association of American Railroads. This table shows that, for the year 1957, 31 States with central assessment were assessing railroad property at a percentage of value higher than the percentage at which other taxpayers' property was being assessed locally. What the table actually did was to compare average assessment-sales ratios for locally assessed real property in the 31 States, as developed by the Census Bureau for the 1957 Census of Governments, with ratios at which railroad property in these States was being assessed in 1957 which were, according to a railroad official,<sup>108</sup> judgment figures furnished by tax administrative and other officers of the railroad industry. On the basis of these figures, the railroads claimed they were being over-taxed by about \$141 million annually.

For more assuring objectivity and precision in determining and measuring discrimination, reference may be made to recent studies by two State legislative committees, both of which retained distinguished appraisal specialists as consul-

ants. The California Joint Interim Committee on Assessment Practices found in 1959 that the property of railroads and other public utilities in California was being assessed at levels approximately twice the statewide average for locally assessed property and that this practice violated the California Constitution.<sup>109</sup> The Colorado Legislative Council Committee on Public Utility Assessments found that in 1959 State assessed properties were being assessed at about 37.5 percent of their market value and that these assessments were not being equalized with local assessments.<sup>110</sup> A staff report of the Council indicated that the level of local property assessments was approximately 27.9 percent of market value.

In only a few recent cases have the courts, on the basis of evidence submitted in the proceeding, determined the degree of inequality. In *Chicago, Burlington & Quincy Railroad Co. v. State Board*,<sup>111</sup> and two companion cases, the Nebraska court found that the method used by the State in arriving at the assessed value for railroad property resulted in an assessed value which was 47 percent of actual value whereas other tangible property was assessed at 35 percent of actual value. This, the court concluded, was unlawful and discriminatory. Illinois now affords a remedy for inequality in a county collector's application for judgment for taxes paid under protest. In such a suit, involving 1957 assessments, *People v. Gulf, Mobile & Ohio R.R. Co.*,<sup>112</sup> two railroads defended that their property in a county was assessed at full value while

<sup>107</sup> *Doyle Report, op. cit.*, p. 458. The study overlooked the fact that other State assessed property is also probably being discriminated against.

<sup>108</sup> James N. Ogden, official of Gulf, Mobile & Ohio R.R. Co., "Railroads Deserve Tax Equality," National Tax Association, *Proceedings, 1960*, pp. 378, 387.

<sup>109</sup> *California Committee on Assessment Practices 1959 Report, op. cit.*, p. 12.

<sup>110</sup> *Colorado Legislative Council Report, op. cit.*, p. vii.

<sup>111</sup> 170 Neb. 77, 101 N.W. 2d 856 (1960).

<sup>112</sup> 174 N.E. 2d 182 (Ill. 1961).

locally assessed property was assessed at less than 50 percent. The assessment ratio determined by the State through its assessment ratio studies for this county was 46.29 percent. Other evidence introduced by the railroads (ratio studies based on appraisals and sales, testimony of experts, and a survey by the county) substantiated that the ratio was just under 50 percent. The court found that the evidence showed gross discrimination against the railroads amounting to constructive fraud and that the railroads were entitled to recover the difference between what they were taxed and what they should have been taxed had locally assessed property been equalized at full value. The county ratio, rather than a statewide or township ratio, was held to be applicable.

Recent cases on inequality brought in Arkansas, Kansas, Kentucky, and New Jersey show that utilities believe that they are being substantially over-assessed in these States in comparison with other property; but they also demonstrate procedural and evidentiary problems in making out a law case for inequality, particularly the difficulty in proving the level of locally assessed property.<sup>113</sup>

<sup>113</sup> *St. Louis-San Francisco Ry. Co. v. Arkansas Public Service Commission*, 227 Ark. 1066 304 S.W. 2d 297 (1957): a railroad alleged that its property was assessed at 20 percent while other property on a statewide average was assessed at 12.32 percent; the court held that the railroad had not shown error and that the 20 percent basis was not confiscatory; *Kansas City Southern Ry. Co. v. Bd. of County Commissioners*, 183 Kan. 675, 331 P. 2d 899 (1958): a railroad's petition alleging that its property in a county was assessed at 60 percent while other property in the county was assessed at 21 percent, as evidenced by a State agency's ratio studies, was held to state a cause of action; *Luckett v. Tennessee Gas Transmission Co.*, 331 S.W. 2d 879 (Ky. 1960) and *Luckett v. Texas Eastern Transmission Corp.*, 336 S.W. 2d 567 (Ky. 1960): the court held that State assessed public utility property had to be assessed at the same level as locally assessed property; *Delaware, Lackawanna & Western R.R. Co. v. Neeld*, 130 A. 2d 6 (N.J. 1957): the court held that railroad assessments should be assessed at the same level as locally

### *The Causes of Inequality*

In most States, the present extent of inequality appears to be less the result of deliberate State policy than a gradual development since the early 1940's arising from differences in assessment practices at the State and local levels. C. M. Chapman describes the progressive development of inequality during this period as follows:

Prior to the present era of inflation, the equalization problem was less acute. It is a well established fact that local assessors have not been able or have been unwilling to keep up with the rapid increase of values of locally-assessable property. As a result, in many states assessment ratios of full value have fallen 50 percent or more. However, many central assessing agencies have been loathe to recognize this trend with the result there has arisen an ever-widening gap between the level of locally-assessed and state-assessed values.<sup>114</sup>

Responsibility for the emergence of this apparently marked degree of discrimination is too diffused, and too varied among the States, to identify precisely; but a large part of it lies in the inadequate provisions, discussed in earlier chapters, for State supervision and coordination of assessment administration. In some States there was no suitable State agency for this purpose, or such agencies lacked the necessary coordinating authority, or lacked the resources for adequate exercise of authority. Often the

assessed property and that the State agency had power to reduce railroad assessments below "true value" but that sales-assessment ratio data could not be used to prove discrimination. The holding in this New Jersey case respecting proof has probably been overruled by the case of *In the Matter of Kents*, 34 N.J. 21, 166 A. 2d 763 (1961) which made the State agency's ratio for a municipality, as determined for purposes of intermunicipal equalization, presumptive evidence of the ratio of assessed to "true value" within the municipality in an individual property owner's suit for inequality.

<sup>114</sup> Chapman, "Property Taxation of Railroad Properties," *op. cit.*, p. 257.



States lacked reliable data on local assessment levels, and when such data were developed they disclosed that the divergence between State and local assessment levels had become so wide as to make any forthright adjustment a hazard to the financial well-being of some local governments. In some instances pertinent data have been suppressed, and there has been no widespread effort to make such data available and useful to the taxpayers. Underlying these administrative shortcomings there has been, with a few notable exceptions, a dearth of legislative and executive support for enforcement of the legal requirements for equalization of State and local assessments and for providing adequate means for their enforcement. This policy, in turn, reflects the unpopularity of any action that would shift more of the property tax load to the local taxpayers.

### EQUALIZATION AND THE PUBLIC INTEREST

Equalization of the assessments of centrally assessed utility property and locally assessed property is entirely feasible. The State assessing agency, like each local assessing agency, must find the market value of the properties under its jurisdiction; and, as shown earlier in this chapter, it is able to do this by use of the appropriate methods with no more difficulty than the local agency encounters in finding the market value of the more complex types of locally assessed property. The State agency also is able, through properly conducted assessment ratio studies, to determine the percentage of market value at which property is assessed in each local assessment district. Uniformity can then be achieved by one of

several methods of adjustment. Thus when the law calls for uniformity, seemingly it should be complied with, and its widespread violation raises questions as to the justification, if any, and the consequence.

The most commonly advanced justification for assessing centrally assessed utility property at a higher level than locally assessed property is that, being highly regulated monopolies virtually guaranteed a fair return on their investments, utilities are tax collectors rather than taxpayers. Since they are permitted to extract the tax from the consumer, they can pay a tax that is twice as heavy as that levied on other property at no cost to themselves. Even if this were universally true, the device is deceptive and inequitable for the taxpayers in general. Some consumers of utility services pay indirectly more than their fair share of local property taxes and even contribute to other communities, while nonconsumer property owners receive the equivalent of partial tax exemption.

The monopoly and fair-return concepts, moreover, range widely in their validity, depending on the policies of the regulatory agencies and the nature of the utilities. While competition is a negligible factor for some utilities, it has considerable significance for others, and for the railroads it means competition not only among themselves but with other types of transportation, some of which are not so highly regulated, that makes them clearly taxpayers and not just tax collectors. Even when a utility is able to earn a fair return on its investment despite the imposition of a discriminatorily high tax, there is some prospect that with the inclusion of this tax in its charges its contribution to a community's economy may

be less beneficial than it should be. An electric or gas utility, for example, may be less able, under such conditions, to encourage the sale and use of major appliances and to influence competitively the price of unregulated heating materials.

The political expediency that underlies the support for continuance of assessment discrimination against the utilities ignores the consequent flouting of constitutional provisions and statutes. To permit administrative agencies to engage in gross violation of the law, or to fail to create suitable agencies with the necessary powers to enforce the law, is a hazardous policy which the public should thoroughly distrust. This state of affairs is the most serious consequence of the failure of equalization. It breeds disrespect not only for the property tax laws but for State government itself.

If judicious analysis of a State's property tax system discloses that the uniformity provisions of the constitution and statutes are undesirable, the appropriate procedure is not to ignore them but to change them. If various classes of property are to be taxed differently, such taxation should be in accordance with law, based on clear authorization for such classification. A proposal to solve California's equalization problem in this manner was made in 1959 by the Joint Interim Committee on Assessment Practices. It recommended that railroad assessments be reduced from 50 percent to the statewide average ratio for locally assessed property (about 25 percent at that time), and that a constitutional amendment be adopted requiring the property of telephone, telegraph, gas and electric companies to be assessed at 50 percent of true cash value. This recommendation, however, has had strong opposition.

#### *Possibility of Federal Intervention*

The present economic condition of the railroad industry has brought the threat of intervention by the Federal government in the area of property taxation. The Doyle study group found that railroads and oil pipelines are more heavily taxed than motor, air, or water carriers, mainly because of local property taxes on the railroad and pipeline rights-of-way,<sup>115</sup> and found, further, that property taxes kept these carriers in a status of relative tax discrimination. Accordingly, the Committee made two specific recommendations:<sup>116</sup>

1. That a Federal law be enacted exempting railroad and pipeline rights-of-way from State taxation, the exemption to take effect gradually over a 10-year period. It was recommended also that State aid be given to localities in hardship cases.

2. That a Federal law be enacted forbidding the assessment of railroad property at a higher ratio of market value than that applied to other property in any taxing district. Jurisdiction would be given to the Federal district courts to enjoin any action violating the interdiction. The jurisdiction would be concurrent with State courts. Two bills embodying this recommendation (H.R. 7421 and H.R. 7497) were introduced in Congress in 1961.

The possibility of Federal intervention led the National Association of Tax Administrators to appoint in 1961 a Committee on *Ad Valorem* Taxation of Railroads and Public Utilities to study the issue of disparities in assessment levels and the effect on the States of congressional legislation such as that proposed in the Doyle Report. Early in 1963 this study was still in progress.

<sup>115</sup> Doyle Report, *op. cit.*, p. 449.

<sup>116</sup> *Ibid.*, pp. 463-466.

## THE PROBLEM OF ACHIEVING EQUALITY

The problem of achieving equality in accordance with the law is one which the States should be able to solve themselves through legislative and administrative processes, as indicated by what some of them have already done or are in the process of doing. Where a large degree of inequality exists, however, the solution is not simple.

### *Avoiding Hardship for Local Government*

When centrally assessed property is assessed at higher levels than locally assessed property, the equalization process involves some shifting of the property tax load within each local taxing district. This shifting is similar to that which occurs in any comprehensive local reappraisal program, and when the utility valuation represents only a small fraction of the total valuation the impact on the local taxpayers is not sufficient to be disturbing; but when the proportion is substantial, as it is in some local jurisdictions, the resulting tax shifting can be economically disruptive and, with the sharp reduction in total assessed valuations, local governments subject to repressive tax rate and debt limits may find themselves without sufficient financial resources to maintain operations. It is important, consequently, that when the disparity in assessment levels is significant, equalization should be accomplished in such manner as to give the local governments time to adjust to the reduction of assessed valuation and shifting of tax load, and to cushion any hardship situations.

One method of tempering the impact of equalization is to make it a gradual process. Oregon has achieved equality in this man-

ner by gradual downward adjustment of the central assessment level over a 10-year period. A disparity of assessment levels developed in the 1940's, and in 1951 the railroads, supported by other utilities, brought evidence before the Oregon Legislature that the assigned county ratios established by the State Tax Commission for equalizing public utility assessments were much too high. The Commission, through its newly organized research facilities, found that the ratios were about 100 percent too high. Subsequent developments, as described in the 1961 Ratio Study of the Tax Commission were:<sup>217</sup>

At an off-the-record meeting between the State Tax Commission and representatives of both the House and Senate Taxation Committees during the 1951 session, the Commission was informed that it was the consensus of these committees that the Commission should reduce ratios to their proper level so as to be fully complying with the law. During the meeting it was suggested that this could be accomplished during the ten-year period set up for reappraisal of the State. The opinion of the Committee appeared to indicate ten years was too long, and a five-year period was recommended instead.

In 1951 and 1952 the 5-year reduction plan was started and the county ratios were reduced accordingly. Smaller reductions were made in 1954 and 1955. In 1956 the reductions were increased again, chiefly because utility companies were paying corporate excise taxes for the first time. In 1957 a legislative resolution was introduced containing a formula for reducing by 1961 the assigned county ratios to the level of the local ratios as determined by ratio studies. Although the resolution was not enacted into law, it was adopted and carried out by

<sup>217</sup> Ratio Study, 1961, *Locally Assessed Property*, Oregon State Tax Commission, Valuation Division.

the Tax Commission, so that by 1961 full equalization had been accomplished.<sup>118</sup>

Several other States have considered and appear to have initiated similar policies. In Kentucky, following the gas transmission line ruling in 1960 that State assessed public utility property had to be assessed at the same level as locally assessed property, the State adopted a policy of gradual approach to equalization which, apparently, the companies are willing to accept.<sup>119</sup> In Colorado, where a study committee of the Legislature found in 1959 that public utilities were being assessed at 37.9 percent and locally assessed property at approximately 27.9 percent of market value, the State apparently is engaged in gradually closing the gap. The Colorado Tax Commission reduced the equalization factor for 1962 public utility assessments to 35 percent.<sup>120</sup>

In California, Chairman George R. Reilly of the popularly elected State Board of Equalization (which is responsible for

the State's share of property tax administration) suggested in 1958, in reply to an inquiry from the Chairman of the Joint Interim Committee on Assessment Practices, that gradual elimination of any substantial inequity would seem preferable to a drastic change, and indicated that "Reduction in the ratio of assessed value to market value of state-assessed property might be accomplished at a rate not exceeding 2 percentage points in any year."<sup>121</sup> (The Committee's consultants found that utility property was being assessed by the Board at approximately twice the statewide average for locally assessed property.) Because of the secrecy of the Board of Equalization regarding the level at which it assesses public utility property, the extent to which the Board may have acted in this manner to narrow the gap is not known. While the Board is required by a 1959 law to determine and publish each year the ratio of assessed to full cash value of locally assessed tangible property in each county, it discontinued in 1959 the disclosure of its basis for the assessment of the unitary property of public utilities.

When, in 1960, the Nebraska Supreme Court disapproved of the application to public utility assessment of a conversion factor which resulted in an assessment ratio of 47 percent while other property was being assessed at a statewide average of 35 percent, the State apparently made the adjustment without resort to transitional steps and was reported in 1962 to be assessing utility property at 35 percent in accordance with the court decision.<sup>122</sup>

While New York still assesses the operat-

<sup>118</sup> In this same period Oregon was carrying on a broad program for the improvement of local assessment practices, thus the atmosphere was right for extending equity to all areas of property taxation. See commentary in vol. 2.

<sup>119</sup> In 1959 the average assessment ratios were 50.9 percent for utility property and 31.1 percent for locally assessed real estate; in 1961 the ratios were 43.9 percent and 30.5 percent. Since in 15 counties public utility property represented over 40 percent of the assessed valuation taxed locally at full rates, this compromise policy avoided considerable local financial disruption.

That the utility companies tend to recognize this problem is exemplified by the statement of the tax analyst of a large public utility that: "any attempt to remove large inequities must be planned so that agencies of local government can adjust their appetites to their metabolism in an orderly fashion, and so that normal accretions of assessed value can do as much as possible to offset the effects of equalization." (Carbert, "Property Tax Administration and Public Utilities," *op. cit.*, p. 146.)

<sup>120</sup> Letter dated June 22, 1962, of Howard A. Latting, Commissioner, Colorado Tax Commission, to ACIR. For the reduction to be meaningful, the assumption must be that locally assessed property is still being assessed at an average statewide ratio of approximately 27.9 percent or higher.

<sup>121</sup> *California Committee on Assessment Practices 1959 Report, op. cit.*, p. 127.

<sup>122</sup> Letter of Tax Commissioner, State of Nebraska, dated May 16, 1962, to ACIR. See also fn. 111.

ing property of railroads locally, the two means used to lessen the impact of tax losses to localities resulting from the partial exemption of railroad property from property taxation are devices that would be equally applicable to a program for eliminating disparities in State and local assessment levels.<sup>123</sup> First, the law granting the exemption provided for a transition period, with one-third of the exemption given the first year, 1960, two-thirds the second year, and all the third year. Second, in addition to giving the localities three years to adjust to the full tax loss, estimated to be \$15 million, provision was made for State aid to cover at least 50 percent of the tax loss to those localities which would be hardest hit.<sup>124</sup>

A device whereby equalization could be effected immediately without undue disruption of local finances has been suggested by Ronald B. Welch.<sup>125</sup> Under this plan, a special excise tax would be levied on the intrastate sales of utilities which would be sufficient in amount the first year to offset the reduction in property taxes caused by the reduction in assessed value, but would be reduced gradually over a period of years and finally eliminated. The proceeds would be used to provide progressively declining grants to local taxing districts to compensate them initially for the property

tax loss and enable them to adjust gradually to the equalized valuation. Regulated public utilities would be permitted to bill the excise tax to their customers but would be required to adjust their rates immediately to reflect the property tax saving. The plan would avoid the uncertainty of completion inherent in an administrative policy of gradual transition, but, as Welch notes, would face the hazard that the new excise tax, instead of gradually vanishing, would tend to become permanent.

### *Role of the Courts*

As indicated by the cases which have been cited, the courts have served to some extent to provide remedies for inequality; but equality forced by court action can be troublesome both for the aggrieved taxpayer and the State.

The experience of railroads in Kansas demonstrates the elusiveness of equalization through court action when the inequality is substantial. In 1958 the Kansas Supreme Court held that State assessed railroad property had to be assessed at the same level as locally assessed property.<sup>126</sup> A railroad official reports subsequent events as follows:<sup>127</sup>

Fearing the submission by the legislature of an amendment to the Kansas Constitution which would permit classification of property so as to place railroads in a class and, as classified, permit them to be assessed on a basis different from that of other property, and, in consideration of a promised program of graduated equalization, the railroads

<sup>123</sup> Article 1-A of the Tax Law, as enacted by ch. 636, New York Laws of 1959. The law did not transfer the assessing function to the State, which could not constitutionally be done because of home rule. However, the railroad ceilings established by the State agency which determine the amount of the exemption reflect system earnings and have some of the earmarks of an assessment.

<sup>124</sup> To those tax districts where railroad taxes exceeded \$100,000 or were 2 percent of the total amount of taxes levied (ch. 637, Laws of 1959 as amended).

<sup>125</sup> Letter of Ronald B. Welch to ACIR, May 11, 1962.

<sup>126</sup> *Kansas City Southern R. Co. v. Bd. of County Comm'rs.*, 331 P. 2d 899 (Kan. 1958). The railroad property was assessed at about 60 percent. The 1957 Census of Government study shows locally assessed real property was being assessed on an average of about 24 percent in 1956.

<sup>127</sup> James N. Ogden, "Railroads Deserve Tax Equality," *op. cit.*, p. 383.

withdrew their protests and dismissed their several complaints without trying them on the merits. It would appear that the railroads won the battle and almost lost the war in Kansas since to date, under the program of graduated equalization, only approximately 10% of the protested and proved discrimination has been removed.

Kansas illustrates the possible political consequences of attempting equalization through judicial enforcement; Illinois exemplifies the burden in time and money imposed on the railroads and other utilities seeking equalization by court action. On the holding in the case of *People v. Gulf, Mobile & Ohio R.R. Co.*,<sup>128</sup> a railroad may now obtain equalization through legal action in each county in which it has property. In each action, it must prove the countywide level of assessment. If inequality exists in every county in the State, Class I line haul railroads with trackage in Illinois would have to file hundreds of tax objection claims a year. One railroad alone, the Gulf, Mobile & Ohio, has filed a total of 136 such claims for the years 1951 through 1961, 78 of which are for the years 1959 through 1961 in 26 counties. Several bills recently introduced in the Legislature requiring assessment of centrally assessed property at the statewide average at which locally assessed property is assessed have failed to pass.

Achieving and maintaining uniformity of assessment among classes of property can best be accomplished by legislative and administrative action within the individual States. The States have the knowledge of local conditions which should enable them to develop, with the least possible adverse effect on localities, programs for achieving equality in accordance with the law.

<sup>128</sup> 174 N.E. 2d 182 (Ill. 1961).

Equality enforced abruptly by court action, Federal or State, is a poor substitute for equality resulting from plans carefully devised to meet local conditions. The proper function of the courts in the equalization process should be as an essential part of the "permanent surveillance machinery,"<sup>129</sup> rather than as the instrument through which equality is achieved.

## METHODS OF EQUALIZING

In the central assessment of property under the unit rule for purposes of local taxation, the initial task of the central agency is to appraise the property at its market value. Presumably, the local assessing process also starts with appraisal at market value. If all locally assessed property were then assessed for taxation at this level there would be no problem of equalization; but in practice the local assessment usually is at some fraction of market value either prescribed by law or in violation of law. Thus the State agency must make some kind of adjustment in order to produce conformity in the State and local levels of assessment. There is a choice of three procedural methods for this process of equalization.<sup>130</sup>

### 1. *Equalization to the Average Statewide Level of Assessment of Other Property*

The equalization is accomplished by computing the statewide ratio (the average of the ratios of assessed to market value for each assessment district in the State) and applying this ratio to the unitary appraised valuations of public utility property within

<sup>129</sup> Carbert, *op. cit.*, p. 146.

<sup>130</sup> James W. Martin has an excellent discussion of the various equalization alternatives in his report on taxation of public utilities in Virginia. *Taxation of Public Service Corporations in Virginia, op. cit.*, pp. 69-86. However, he evaluates the alternatives within the framework of Virginia laws and policies.

the State before apportionment to the local taxing districts.

Full equality is not achieved when this method is used exclusively. If the ratio for locally assessed property in a utility's operating area is lower than the State average ratio, utility property is taxed more heavily than other property; if the reverse is the case, nonutility property is taxed more heavily.<sup>131</sup>

### 2. *Equalization of State Assessments and Local Assessments to a Common Level*

Under this method, the State equalization agency is authorized to order changes in the average assessment levels of property in the local assessment districts, to conform with a uniform standard, such as "full value", or "true value", or a fraction thereof. Centrally assessed property is then assessed according to this uniform standard and the totals are allocated.<sup>132</sup>

### 3. *Equalization of State Assessments to the Level of Local Assessments*

To accomplish this result, the State agency determines annually the ratio of assessed to market value of locally assessed taxable property in each assessment district and then converts to assessed value for each taxing district its allocated share of the market value of the unitarily assessed prop-

erty by application of the appropriate local ratio.

Both the second and third procedures will produce equality in the treatment of State-assessed and locally assessed property if they are conducted reliably and competently. The third procedure is more simple as it does not require the local assessment districts to make changes in the levels of their assessed valuations. This method of equalization has been recommended in chapter 6, with the proviso that State determined market value, rather than the assessed value, of taxable property in each assessment district shall be used as the base for tax rate and debt limits and other measurement purposes for which assessed value usually is employed.

### *A State Tax as an Alternative*

The taxation of public utility property by the State, with the tax measured by the average rate of taxation on the full value of other taxable property in the State, is by far the simplest method of achieving equality. This method does require that the State maintain a sound ratio study program, as the responsible State agency must know the market value of all taxable property; but it does not involve the allocation of unitary assessments to the local assessment districts. With the State levying and collecting the tax, each utility receives and pays one tax bill, a procedure that simplifies billing, collecting, and taxpayer compliance.

If the proceeds of the tax are designed for local use, the State still has the problem of apportionment; but, as noted in the discussion of intrastate allocation above, the State is in a position to distribute these funds on the basis of some equitable and sound policy, unrestricted by the fortuity of the

<sup>131</sup> The Illinois court recently refused to use this method (*People v. Gulf, Mobile and Ohio R.R. Co.*, 174 N.E. 182, 187 (Ill. 1961)), saying, "To use an average State-wide ratio in determining the degree of discrimination against railroad property would penalize the taxpayers in those counties in which the goal of full value assessment has most nearly been achieved • • •."

<sup>132</sup> Illinois, for example, employs this type of equalization. The law requires a State agency to equalize local assessments to full value (Ill. Rev. Stat. 1955, ch. 120, par. 627) and the agency is directed to assess public utility assessments at full-value (*idem.*, ch. 120, par. 561). For discussion of difficulties encountered see vol. 2, Illinois, and Illinois Legislative Council, *Equalization of Property Tax Assessments*, Bulletin 3-018, Springfield, 1957.

particular method chosen for allocating market value.<sup>133</sup>

Wisconsin achieves equality effectively by this method. The operating property of railroads and of most classes of public utilities is taxed *ad valorem*, with the railroads, and the utilities owning and operating property in more than one municipality, assessed by the State on a unitary basis and taxed only by the State. The properties are assessed at full value and taxed at the average full value tax rate for the State. This rate is determined each year by dividing the aggregate levy of the State, county, local, and school taxes for the previous year by the full value of all taxable general property in the State for the current year.<sup>134</sup> Railroad taxes (except for terminal taxes returned to lakeport cities) and air carrier taxes are retained by the State, thus creating no problem of allocating the proceeds. Some or all of the proceeds of the property taxes levied on the other classes of utilities are distributed to local governments, necessitating allocation formulas, but the procedure is less onerous than allocating assessed valuations.<sup>135</sup>

<sup>133</sup> Since the great majority of States have local taxing limits, borrowing limits, or both, related to the local assessed valuation, the removal of utility property from the local tax base for taxation by the State would call for some appropriate adjustment in the limiting formulas of these States.

<sup>134</sup> For the procedure used by the State Department of Taxation in assessing all property at full value, see vol. 2, Wisconsin.

<sup>135</sup> Michigan centrally assesses, for property taxation exclusively by the State, the operating property of railroad transportation and communication companies, and directs the proceeds to local use without resort to allocation formulas by earmarking them for the primary school interest fund. Under the State's new Constitution approved by the voters in 1963, the Legislature is given authority to provide for State assessment and taxation of other classes of property. The new Constitution provides, also, that the proportion of true cash value required by law for assessment of property subject to general *ad valorem* taxes shall apply to property assessed by the State. Under the

## ACHIEVING AND MAINTAINING EQUALITY

Joint State-local assessment administration is seriously defective when divided responsibility for assessing lacks the needed coordination to provide the uniformity required by law. This lack is particularly conspicuous in the instance of those States which have failed to achieve equalization of the assessments of centrally assessed utility property and locally assessed ordinary property; but such failure also carries an implication of the inability of those States to centrally assess other types of property on an equitable basis. There are too many potential advantages in the central assessment of several classes of property to permit this defective coordination to go unremedied.

The fact that the law specifies a suitable method of equalizing the assessed valuations of State assessed and locally assessed property provides no assurance of equality. Only when the law has effective enforcement are the desired results obtainable. The prerequisites are those for successful joint State-local assessment administration which have been discussed previously, mainly in Chapter 11. Given a law that is administrable and provides clear guidance, the supporting essentials are:

1. A single, well-integrated State administrative agency responsible for the State's entire share of assessment administration, provided adequately with professional per-

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preexisting provisions, the State tax on the centrally assessed utilities is designated as a "specific tax", with the assessment to be at true cash value and the rate to be the average rate levied upon other property in the State under the general *ad valorem* tax law. The new Constitution provides a similar method for determining the rate but empowers the Legislature alternatively to provide that the rate shall be the average rate of *ad valorem* taxation on other property in all counties where the enterprise has property.



sonnel, appraisal and research facilities, and financial resources.

2. The regular conduct of scientific assessment ratio studies that disclose the levels of assessment of the major classes of property, and the regular publication of assessment ratios for the major classes of both State assessed and locally assessed property.

3. Adequate authority, in accordance with the method established by law, for the State agency to equalize the levels of assessment of State assessed and locally assessed property on the basis of the findings disclosed in the studies.

4. To provide the taxpayers with an effective remedy for inequality, creation of an independent and professionally qualified State board of tax appeals, or tax court, with authority for the aggrieved taxpayers to introduce as evidence the assessment ratios determined by the State agency through its studies.

Underlying these essentials and determining their degree of effectiveness, however, is the will of the legislative and executive branches to achieve and maintain sound, equitable property tax administration.



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The publications by State agencies concerned in one way or another with property tax supervision comprise, in the aggregate, a valuable source of information on this subject, though their comprehensiveness and quality vary widely. Agencies in most States issue periodic statistical reports covering such data as assessed valuations, tax levies and tax rates of some or all local governments; while the regular annual or biennial reports of tax departments, tax commissions, or other administrative agencies having property tax responsibilities, in the minority of States in which the State share of property tax administration is more or less well organized and developed, carry additional current data. The better-quality reports include such features as statistical analysis, resumés of agency plans and accomplishments, explanations of new legislation, and digests of pertinent new court decisions. A descriptive list of periodic State publications that contain data on local government finance, including the property

tax, is given in the Census Bureau's *State Sources of Data on Local Government Finances*, 1962 Census of Governments, Preliminary Report No. 2.

All of the reasonably well organized and equipped State agencies for property tax supervision issue special publications, primarily for the education and guidance of assessors and other local tax administrators, that are an increasingly valuable contribution to the technical literature in this field. They include, mainly, assessors' handbooks, setting forth pertinent laws, interpretations and instructions; appraisal manuals, including special manuals for the appraisal of complex types of property; price and other schedules relating to the assessment of personal property; and, in a few States, monthly information bulletins. Numerous specific references to such publications are made in Volume 2.

The work in the property tax field of the Governments Division of the Bureau of the Census of the U.S. Department of Commerce is extraordinarily useful. The 1957 and 1962 Censuses of Governments, in addition to providing State-by-State data on the nature and role of the property tax, on property tax revenues, and on assessed valuations by major classes of property, etc., conducted assessment-ratio studies that permitted the presentation, by States and selected local assessment districts, of information on the level and quality of local real property assessment. Reference should be made particularly to *Taxable Property Values* (Volume V of the 1957 Census and Volume II of the 1962 Census). The data on State and local government finance which the Division compiles and publishes promptly each year include property tax revenue statistics.

The professional journals for tax economists, tax administrators, lawyers, etc., are a fruitful source of information on current research, expert opinion, controversial issues, and newly developing programs in the property tax field. Articles on the property tax appear frequently in the *National Tax Journal*, published quarterly by the National Tax Association, the monthly *Tax Administrators News* of the Federation of Tax Administrators, and *Tax Policy*, a monthly publication of the Tax Institute of America, while pertinent articles appear from time to time in the various law reviews and other professional periodicals. The *Assessor's News Letter*, issued monthly by the International Association of Assessing Officers, specializes in this vital phase of property tax administration.

The published proceedings of the annual conferences of the National Tax Association, National Association of Tax Administrators, and International Association of Assessing Officers all carry papers presented by property tax specialists. The proceedings of regional and State conferences of tax administrators and State schools for assessors often include valuable material on the property tax, but they are available only to a limited extent in published form.

Among the bibliographical aids to finding the scattered current literature on the property tax the *Tax Institute Bookshelf* is particularly valuable. Published semi-annually by the Tax Institute of America, it comprises a comprehensive index of recently published public finance materials, with its use facilitated by topical classification and cross referencing.

Much of the best property tax research is to be found in the special studies conducted by State tax study commissions, legislative councils, legislative interim commit-

tees, and their consultants, and by the research divisions of State tax departments and other government agencies with an interest in the property tax. Also, there are a number of noteworthy special studies by university and civic research groups, study committees of professional associations, and individuals. While most of these studies relate to the problems of individual States, much of the analysis and findings is relevant to the problems of other States. Some studies deal exclusively and broadly with the property tax, but more of them include sections on this tax in comprehensive tax studies, or concentrate on special features of the tax and its administration. Note should be made that some of the recent critical reports dealing with individual States are already out-of-date in the sense that portions of their recommendations have been officially adopted. Most of these studies have a limited circulation and some of them are designed for internal use and remain unpublished. A representative but by no means complete list of recent studies follows:

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