

## WHO WINS IF THE PROPERTY TAX CAP PASSES?

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### Who Pays the Property Tax Now?

Homeowners, residential landlords, and commercial property owners write checks in the following proportions when Anchorage collects the property tax:

#### The Shares of Property Tax Revenues (based on 1996)

Homeowners	43%
Residential Landlords	26%
Commercial Property Owners	32%

Most, but not all Anchorage property, is owned by residents. On the list of largest property owners are a number of non-resident businesses (known non-resident in bold type).

#### The 20 Largest Assessed Values in Anchorage in 1997 (million \$)

Total of 20 largest	\$992
Hickel Investment	\$92
<b>Carr-Gottstein</b>	81
<b>Galen Hospital Alaska</b>	74
<b>Wal-Mart</b>	61
<b>ARCO</b>	58
<b>BP Exploration</b>	57
Calais Company	55
Bristol Corporation	50
<b>Seibu Alaska</b>	47
Dean W. Weidner	46
<b>Fred Meyer</b>	44
<b>Federal Express</b>	41
<b>K-Mart</b>	39
<b>Equitable Life Insurance</b>	39

Alascom	38
<b>Costco</b>	37
<b>Enstar</b>	35
<b>National Bank of Alaska</b>	34
Dimond Center	33
First National Bank	31

Some of the tax burden gets passed on without resistance to the federal government since the property tax is deductible from federal income taxes for homeowners who itemize as well as for businesses.

Homeowners thus get the federal government to share in their property tax burden. Landlords over time will SHIFT their tax burden onto tenants—renter households and businesses--as higher rents. Businesses over time will SHIFT their burden onto their customers as higher prices (or their stockholders if they cannot). These burden shifts are largely successful because the supply of apartments and commercial property is quite sensitive to its rental price while the demand is much less so.

The attached SHIFTING DIAGRAM shows how \$100 of property taxes is shifted and comes to rest at the doorstep of households, both in Anchorage and elsewhere. \$75 of each \$100 of property tax revenues ends up being paid by Anchorage households, through a combination of higher cost for shelter and higher prices for locally purchased consumer goods.

Of the \$25 that is not paid by Anchorage residents, the bulk (\$19) is paid by federal taxpayers in other states whose taxes increase to offset the loss from reduced federal taxes paid by Alaskans.

\$2 is passed to companies located in Anchorage that sell into the world market who cannot shift the tax on as higher prices. They absorb the tax as lower profits paid to their stockholders.<sup>1</sup>

The remaining \$4 comes from visitors paying higher prices while shopping in Anchorage (and persons ordering goods from Anchorage stores). About half of this, \$2, is paid by in-state visitors and \$2 by out-of- state visitors (tourists and business travelers). The burden falling on visitors is small because non-resident purchases make up only about 15 percent of total Anchorage retail sales.

The specific mechanisms of shifting are as follows<sup>2</sup>:

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<sup>1</sup> For petroleum companies the local property tax reduces their state property tax liability by an equal amount, so profits are not affected.

<sup>2</sup> Of course landlords cannot SHIFT all the property tax onto renters and tenants. They absorb the share of the tax that falls on land and pass most but not all of the share that

1. Homeowners pass part of their burden onto the federal government by reporting higher itemized deductions that lower their federal income tax liability.
2. Other property owners pass part of their burden onto the federal government by reporting a higher cost of business that lowers their federal income tax liability.
3. Residential and commercial landlords pass the remaining burden onto their tenants as higher rents.
4. Businesses selling into the Anchorage market pass their burden onto their customers (both Anchorage residents and visitors) as higher prices.
5. Businesses selling into world markets pass their burden onto their stockholders as lower profits.

The property tax does not affect the price of real estate but the rental cost of property does increase by the size of the tax.<sup>3</sup> This will have some negative effect on the demand for rental housing, commercial property, and residential housing. In the absence of an increase in services to property, financed by the tax, the cost of living would marginally increase.

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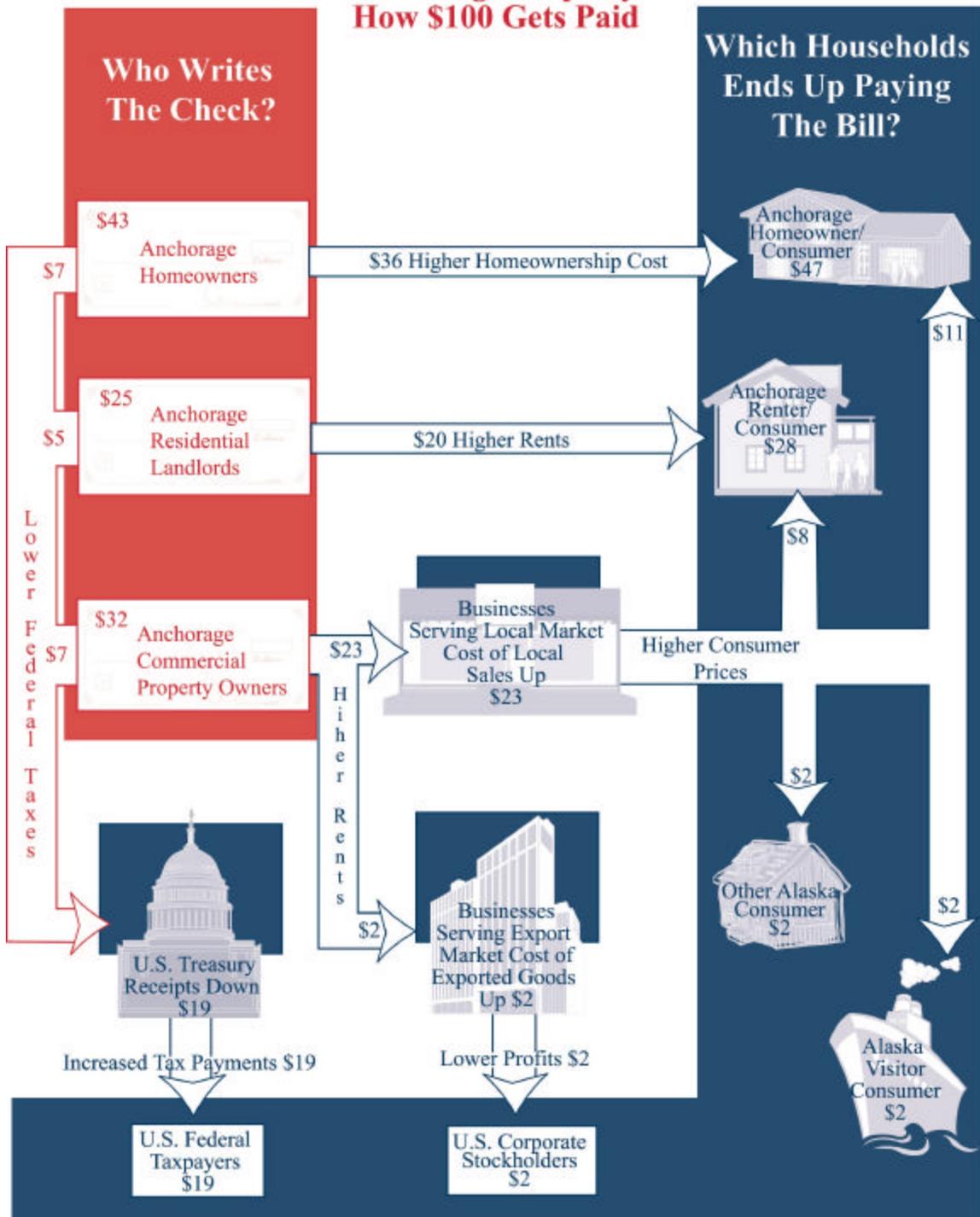
falls on improvements onto tenants. If the demand for property is sensitive to the price some of the tax on improvements will stay with the landlord. For example, if tenants have the potential to move out of Anchorage, they will force some of the tax back on the landlords. Likewise businesses cannot SHIFT all of their tax onto customers if demand is sensitive to price. For example if consumers have the potential to shift their purchases out of Anchorage, they will force some of the tax back on businesses.

If landlords only shifted half of their tax burden onto renters and tenants, the burden would fall less on renters and consumers and more on property owners, some of whom are non-residents. Overall residents would pay about the same share of the tax, dependent upon the non-resident share of ownership of rental property.

<sup>3</sup> The process of SHIFTING the tax does not occur instantaneously. Multi-year leases cannot be broken. Everyone tries to avoid having the burden shifted onto his shoulders.

The immediate effect of imposition or increase in a property tax is to reduce the return on investment in land and property (including home ownership). This causes the price of land and property to fall as the lower return (the present value of the future higher tax bills) is capitalized in the value of the property. Property owners suffer an immediate loss. Over time the abnormally low rate of return will cause the supply of property (buildings) to fall. At the same time the price of the remaining real estate will rise as the tax burden is shifted to renters and tenants. With elastic supply and inelastic demand, the price will eventually return to a level close to the pre property tax level.

## The Anchorage Property Tax How \$100 Gets Paid



## Who Would Pay Less With a Property Tax Cap?

A reduction in the property tax would work in just the opposite direction from an increase. The tax bills of property owners would fall. Lower property taxes would increase the federal tax liability of homeowners and businesses, shifting 19% of the savings to the federal treasury and ultimately to federal taxpayers in other states. Stockholders of businesses selling into the world market would pocket their 2% share of the tax cut.

Landowners and businesses would resist the market forces operating to shift their savings to tenants and customers. However competitive pressure would eventually force them to pass the savings on in the form of lower rents to tenants and lower prices to customers.

Resident households would end up pocketing about 75% of the reduction in the property tax. Visitors would get the other 4%.

It is estimated that the property tax cap would reduce Anchorage property tax revenues by about \$75 million in the first year. The savings would pass through to households in the following shares:

### Households Paying Less With the Tax Cap in Place (million \$)

Total	\$75
Anchorage Households	\$56.2
In-state visitors	\$1.4
Out-of-state visitors	\$1.2
US Federal Taxpayer Households	\$14.4
US Stockholder Households	\$.9
Alaska State Taxpayer Households	\$.9

A lower property tax would not affect the price of real estate but the rental cost of property would decrease by the size of the tax. This would have some positive effect on the demand for rental housing, commercial property, and residential housing. In the absence of a decrease in services to property, financed by the tax, the cost of living would marginally decrease.

This is a description of the final disposition of the savings. As with a tax increase, it would take some time for the real estate sector to adjust to the reduced tax. The immediate effect of reducing the property tax would be to increase the return on

investment in land and property (including home ownership). This would cause the price of land and property to increase as the higher return (the present value of the future tax savings) is capitalized in the value of the property. Property owners enjoy an immediate gain. Over time the abnormally high rate of return would cause the supply of property (buildings) to increase. At the same time the price of the remaining real estate would fall as competition shifts the tax burden to renters and tenants. With elastic supply and inelastic demand, the price would eventually return to a level close to the level before the tax reduction.

### **Who Would Get Reduced Public Services?**

Up to this point we have ignored the loss of public services—road maintenance, police and fire protection, education—that would result from reduction in the property tax. While it is relatively straightforward to determine who wins from lower taxes, it is more difficult to assess who loses from reduced public services. We take this question up elsewhere, merely pointing out here that the property tax cut is not without costs, largely to the same households that currently pay the property tax.

## RECOUPING THE LOST PROPERTY TAX REVENUES—WHO WOULD PAY?

Since reducing the property tax would not eliminate the need to provide the public services paid for with the tax, some other means to pay for these services would be found, most likely with a sales tax or user fees. Since the estimated loss in property tax revenues to Anchorage in the first year of a property tax cap would be about \$75 million, we look who would pay that bill with a sales tax or user fees and how the liability compares to that of the property tax.

The bottom line on this analysis is that the best method for passing the cost of service provision off the shoulders of Anchorage residents would using a seasonal sales tax. A regular sales tax would be the least successful in passing the burden off Anchorage residents.

### Who Pays The Bill—4 Alternatives

	Property Tax	Sales Tax	Seasonal Sales Tax	User Fees
Anchorage Residents	75%	85%	66%	82%
Visitors	4%	15%	34%	4%
Federal Govt	19%	--	--	12%
Stockholders	2%	--	--	2%

This analysis of alternative payment mechanisms ignores their differential costs, administrative and otherwise, of collection and enforcement. It also does not investigate the relative shift in burden between lower or higher income households with each alternative.

### General Retail Sales Tax

A general tax of 2% covering all retail sales would recoup the revenues lost from a cap on the property tax. The burden would fall squarely on the shoulders of consumers. There would be no deduction by either households or business for sales taxes paid when calculating their federal income tax. Stockholders of Anchorage businesses that sell into the world market would make no payments through a sales tax.

Visitors to Anchorage (and shoppers by mail) would pay 15% of the tax. About half of this would be paid by in-state visitors, while the remainder would be paid by out-of-state-visitors (tourists and business travelers).

Anchorage residents would pay 85% of the sales tax since that is the resident share of retail sales within the city. Since Anchorage residents are both consumers and householders, the shift from the property to the sales tax would largely leave the same group paying for public services, but out of a pocket labeled sales tax rather than a pocket labeled property tax.

Compared to the property tax, the sales tax does increase the burden of paying for public services to visitors from 4% to 15%. However it also increases the burden on Anchorage residents from 75% to 85%. The reason for this is that neither the federal government nor export businesses contribute to paying the sales tax.

In the unlikely event that the sales tax were absorbed by business and not passed on to customers, the burden would fall squarely on retail businesses serving the Anchorage market. Although most retail businesses are locally owned, many of the larger ones are not. The tax burden in this case would fall primarily on Anchorage households that own these businesses, but some would be passed on to non-Anchorage households.

### **Seasonal Sales Tax**

The rationale for a seasonal sales tax is to force visitors, whose retail purchases are thought to be concentrated during the summer season, to pay a larger share of the tax. A seasonal tax on all retail sales would have to have a rate of at least 6% in order to recoup the loss of \$75 million from imposition of a tax cap in Anchorage.

The amount collected and the share shifted to non-residents would depend upon the purchases by residents and non-residents during the months when the sales tax was in effect. We do not have much hard information to estimate these amounts, but with a few simple assumptions we can get a good idea of the potential magnitude of a seasonal sales tax.

1. The seasonal sales tax is in effect for the three months of June, July, and August
2. 75% of non-resident purchases occur during these three months. (Some out-of-state visitors come in the off-season and in-state visitors make retail purchases in Anchorage throughout the year.)
3. Resident purchases exhibit no seasonality (In fact sales of some things are higher in the summer—garden supplies—while others peak at other times during the year.)
4. Neither residents nor non-Anchorage Alaskans shift their purchases to other locations or other times of the year in response to a seasonal tax. (The 6% seasonal sales tax rate would be a strong incentive to shift purchases out of

Anchorage, to Wasilla for example, during the tax season. Most shifting of purchases would likely be for durables such as automobiles and appliances that can be postponed rather than for things like food and medicine.)

Based on these simple assumptions along with the knowledge that about 15% of total retail purchases in Anchorage are made by visitors, about 34% of the tax would be paid by visitors. The visitor share would increase (and the amount collected decrease) to the extent that consumers shifted their purchases out of town and off-season. The non-resident share would decrease (as well as the amount collected) to the extent that non-residents made their purchases in the off-season or out of town.

Anchorage residents would pay 66% of the tax, again assuming no shifting of purchases out of town or out of season. For residents the burden of this tax would fall most heavily on the purchase of consumables such as food, gasoline, and medicine that cannot be easily postponed.

Compared to the property tax the seasonal sales tax does increase the burden of paying for public services to visitors from 4% to 34%. It decreases the burden on Anchorage residents from 75% to 66%. As with the regular sales tax, neither the federal government nor export businesses contribute to paying the seasonal sales tax.

## **User Fees**

The city or private industry could continue to provide the public services formerly financed by the property tax and charge a user fee. The notion would be that the user fee would closely match the value of the service delivered. User fees for development infrastructure (roads, sewers, etc.) and services to property (property transfer fees, etc.) proliferated in California after the passage of the tax cap.

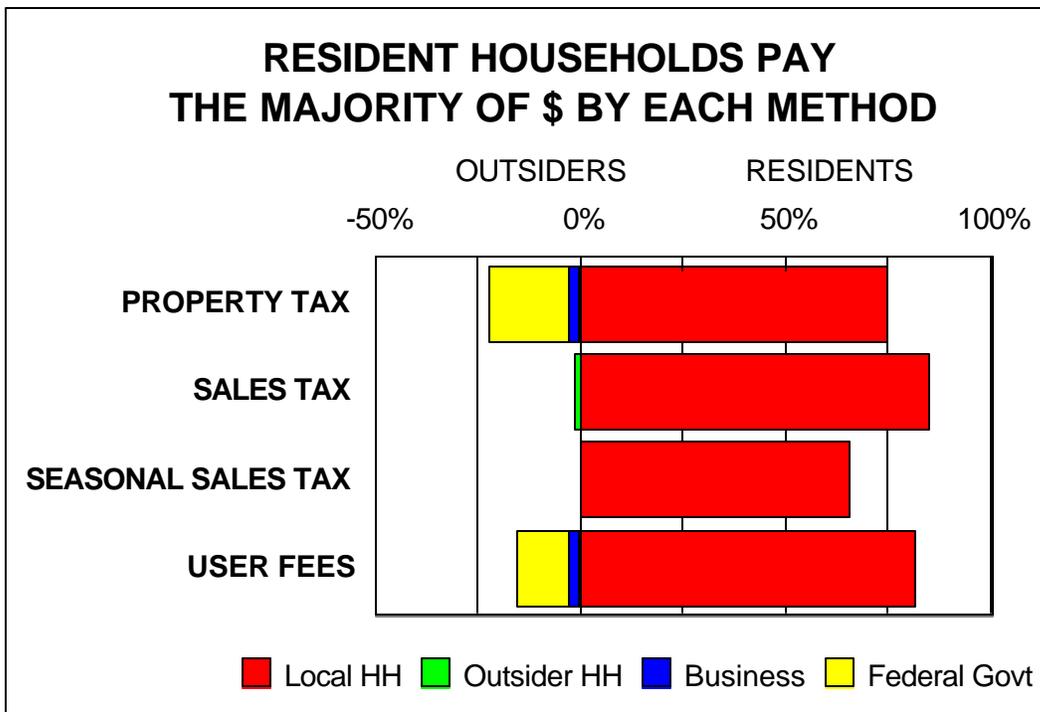
This alternative financing mechanism raises questions about the potential cost savings from privatization of services, economies of scale in service delivery, and how to set the fees to match the service. We set aside those issues by assuming that the cost of the services would not change by shifting to user fees, and the assignment of fees would fall on property, just as the property tax now does.

As with the property tax, property owners would shift the payment of user fees onto tenants as higher rents and businesses would shift the burden to consumers through higher prices. Landlords and tenants would be able to pass 12% of the burden on to the federal government by declaring the fees as a cost of business, thus reducing their federal tax liability. Businesses selling to the world market would pass their 2% share on to their stockholders as lower profits.

Visitors who shop in Anchorage would pay 4% of the user fees. About half of this would be paid by other Alaskans and the other half by non-Alaskan tourist and business travelers.

Anchorage residents would pay 82% of the user fees. Since Anchorage residents are both consumers and householders, the shift from the property tax to user fees would leave the same group paying for public services, but out of a pocket labeled user fees rather than a pocket labeled property tax.

Compared to the property tax, user fees increase the burden of paying for public services for Anchorage residents from 75% to 82%. The visitors share is unchanged at 4%. The federal government share falls from 19% to 12% since user fees are not federal tax deductible for individuals. Export business shareholders contribute the same 2%.



## LOW VS. HIGH INCOME HOUSEHOLDS: WHO PAYS MORE?

The property tax is generally considered to be REGRESSIVE, meaning that lower income households pay a larger percentage of their income as property taxes than higher income households. This is because housing is a larger share of the budget of lower income households, landlords pass the property tax on to renters and tenants, and tenants pass the tax on as higher prices for consumer goods. However it is less regressive to the extent that the tax is paid by households owning commercial real estate, generally higher income, if they are unable to pass the tax onto others.

The sales tax is also considered to be REGRESSIVE. This is because lower income households spend a larger percentage of their income on consumption goods than higher income households. The degree of regressivity of the sales tax depends upon a number of factors including what items are exempted from the sales tax and whether tax ceilings are imposed on certain large purchases.

The excise tax, imposed as a percentage of the price of certain retail purchases such as gasoline, tobacco, or liquor is more REGRESSIVE than either a sales or property tax. This is because consumption of these goods falls as a percentage of income for higher income households.

In contrast, the income tax is generally the most PROGRESSIVE of the major taxes that households pay. In many locations the tax rate increases with income, more than offsetting the effect of higher deductions available to higher income households.

### Ranking of Major Taxes on Households

More Regressive = Poor Pay Higher % of Income

Excise Tax  
Sales Tax  
Property Tax  
Income Tax

More Progressive = Rich Pay Higher % of Income

These measures of tax incidence by income do not consider the incidence of the public expenditures financed by these various taxes.

Although the tax burden on Alaska households is low compared to other states, because it relies on excise and sales taxes, it is more REGRESSIVE than the US average. In 1995

the percentage of income paid in taxes by the lowest income Alaskans was 3 times that of the highest income Alaskans. For the average state the ratio was 1.5.

Percent of Income Lost as State and Local Taxes in 1995:  
Non-Elderly Married Couples

	Lowest 20% of Households	Highest 20% of Households
Alaska	-6.9%	-2.3%
US Average	-12.5%	-9.0%
Alaska with Permanent Fund Dividend	+15.5%	+ .3%

Source: Who Pays? Citizens for Tax Justice and Institute on Taxation and Economic Policy, June 1996, and authors.

However if the Permanent Fund Dividend is included as a negative tax, the tax structure of Alaska becomes highly PROGRESSIVE. With the growth in the size of the dividend in the last 5 years, the progressivity has become more pronounced.