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America's regressive wealth tax: state and local property taxes

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ABSTRACT
Most taxes in the United States are levied on income flows, not capital stocks. One notable exception is state and local property taxes. This note documents their magnitude and regressivity. Property taxes account for more than 30% of state and local tax revenue, and amount to an effective wealth tax rate of 0.86% on the assets of the median US homeowner. The effective property-wealth tax rates are highest for younger, lower-income homeowners.

KEYWORDS
Property taxes; distribution; equity; inequality

JEL CLASSIFICATION
H20; H70

Tax policy in the United States has long included an underappreciated, substantial, and regressive tax on wealth in the form of state and local property taxes. This note describes their magnitude and distribution across homeowners' incomes and age groups.

Nationwide, property taxes account for more than 30% of state and local tax revenue.[1] The rates vary. Figure 1 plots the median rates paid in each US state, using data from the American Community Survey.[2] The lowest rates are in Louisiana, where the median is 0.25%; the highest are in New Jersey, at 2.6%.

Property taxes are wealth taxes not income taxes, because they are assessed on a stock of capital, not on a flow of income. Two particular features make them regressive. First, property taxes rates are levied on the full assessed value of homes, not just homeowners' equity. And second, they only tax property, ignoring stocks and other holdings.

I. American property taxes are regressive: the evidence

The median American homeowner in the 2016 Survey of Consumer Finances had 231,000 USD in net worth, of which 100,000 USD was home equity, and paid 2,000 USD in real estate taxes.[3] That amounts to an effective 0.86% tax rate on net worth – a wealth tax.

Three main features of the data combine to make that property-wealth tax regressive: the size of homeowners' mortgages relative to their homes' values, homeowners' other assets, and homeowners' ages. To assess the regressivity of property taxes, we need to account for all three.

First, consider a person whose only asset is a house worth 200,000 USD – a bit less than the current median US value according to the web site Zillow.com.[4] If the homeowner pays typical annual property taxes of 1%, that would be 2,000 USD in taxes. But if they have borrowed three-fourths of the money for the house, their net worth is only 50,000 USD. So that 2,000 USD property tax bill amounts to a 4 percent wealth tax, much higher than any rate currently being debated. Property tax rates ignore the fact that homes' assessed values may be larger than their homeowners' equity.

Second, note that property taxes exclude wealth in bank accounts, stocks, bonds, or other more exotic holdings. For most Americans fortunate enough to own a home, that distinction does not matter. Their houses make up most of their net worth. Richer homeowners, by contrast, typically own other assets aside from their houses, so property taxes target a smaller fraction of their overall

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[1]2017 Census of Governments, www.census.gov/data/datasets/2017/econ/local/public-use-datasets.html accessed 27 April 2020.

[2]Also see Harris and Moore (2013).

[3]See Bricker et al. (2017) for a description of the 2016 Survey of Consumer Finances.

[4]Accessed 22 November 2019.

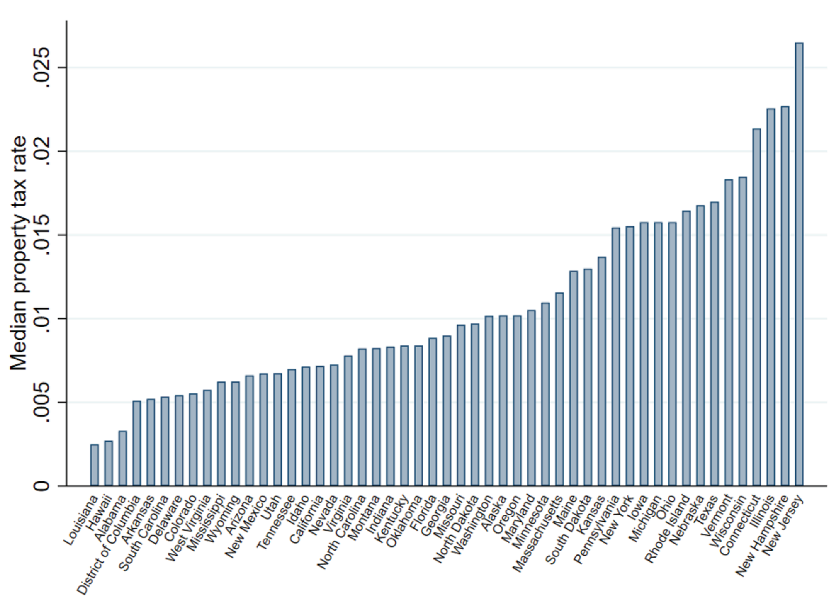

Figure 1. Property tax rates. Source: US Census Bureau, American Community Survey, 2013–2017.

net worth. That pattern turns the property tax into a regressive wealth tax.

Put simply, property taxes amount to a wealth tax on a narrow basis:

$$t_w = \frac{t_p V_p}{V_p - M_p + Z}$$

where t_w is the effective wealth tax rate, t_p is the statutory property tax rate, V_p is the value of the property, M_p is the remaining mortgage balance on the property, and Z is other investment holdings. For richer households, $V_p - M_p$ and Z in the denominator are both larger, so t_w falls with income.

Third, age exacerbates the regressivity. Older households tend to have owned their homes for more years, which means the value of their homes V_p has risen and more of the mortgage M_p has been paid off. Home equity $\left(V_p - M_p\right)$ thus represents a larger share of older homeowners' overall wealth, all else equal. A tax on the total value of their homes represents a smaller overall wealth tax. Since older homeowners tend to be richer, this makes the property tax regressive.

Older homeowners also tend to have larger non-property holdings, Z. So older households face lower property-wealth tax rates for two reasons: their mortgage balances are lower and their non-property assets are larger. But the regressivity of t_p is not only a function of age. Property taxes are regressive even within homeowners of the same age.

Figure 2 plots home equity as a share of household net worth, by age and decile of homeowners' incomes. Home equity makes up 45% of net worth for the median American homeowner, and that share declines steadily with income. For the 10% of US homeowners with the lowest incomes, home equity accounts for 82% of their net worth. For the richest 10% of US homeowners, home equity makes up 17% of their net worth. Put differently, 82% of the assets of low-income homeowners are subject to a wealth tax in the form of property taxes; only 17% of the assets of high-income homeowners are subject to the property-wealth tax.

Figure 2 also demonstrates that while age explains part of the reason home equity's share of net worth declines with income, it is by no means the entire explanation. For each of the three age groups – younger than 40, 40 to 59, and 60 and over – home equity as a fraction of net worth declines steadily with income. The drop in home equity share is larger across income for any age group than it is across age groups in any income category.

Because home equity is a smaller share of total assets of richer households, the property tax is

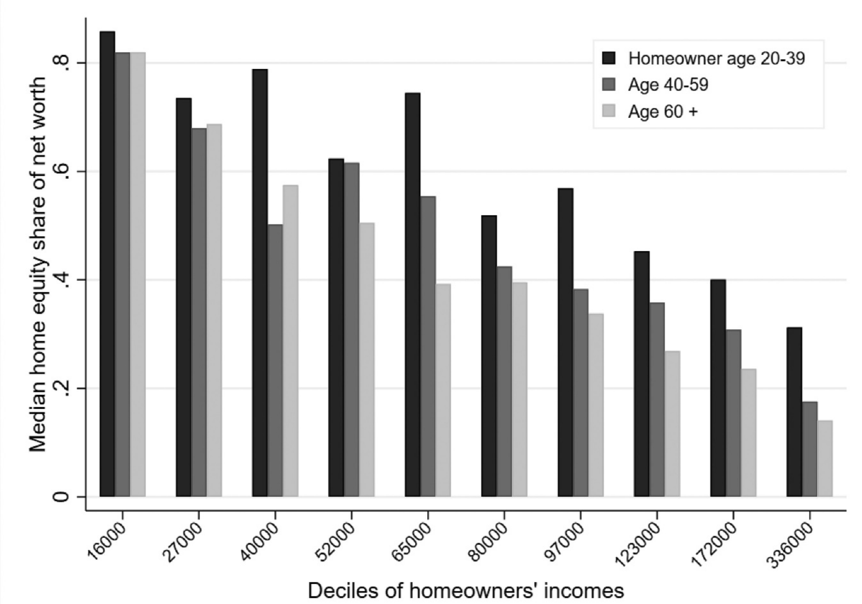

Figure 2. Home equity's share of household net worth. Source: US Federal Reserve Board, Survey of Consumer Finances, 2016. Dollar values on the bottom axis represent the median incomes for each decile. I.e. the median household income among the richest 10% of homeowners is 336 thousand USD.

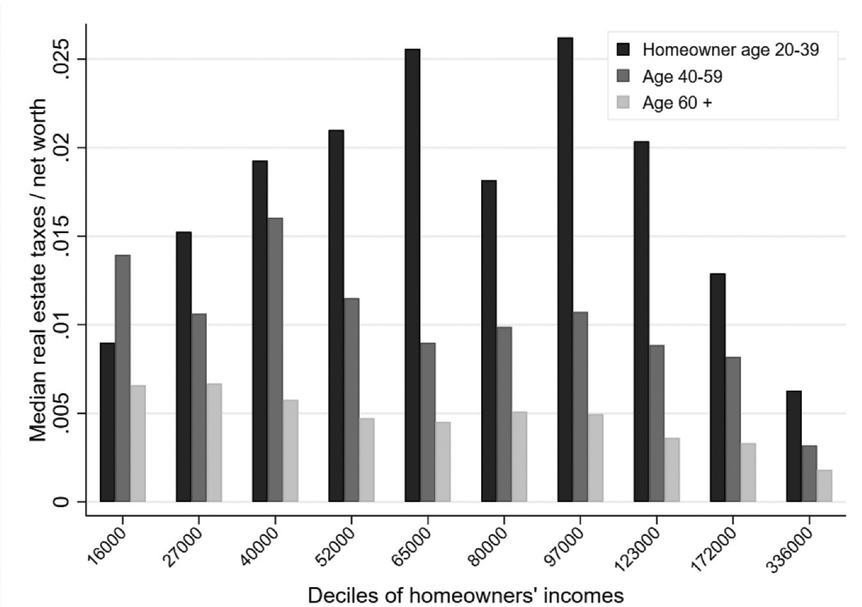

Figure 3. Property taxes as a share of net worth. See notes for Figure 2.

regressive. Figure 3 documents that regressivity. The 10% of homeowners with the lowest incomes pay property taxes that amount to a 0.89% wealth tax. The richest homeowners face an effective wealth tax rate only a third as steep, 0.29%. When described that way, as a fraction of total net worth, property tax rates appear to be relatively flat across homeowners' incomes for all but the richest 10%.

But the pattern across age groups looks quite different. For homeowners age 40 and older, property taxes paid as a share of net worth declines steadily with income, a regressive pattern. For

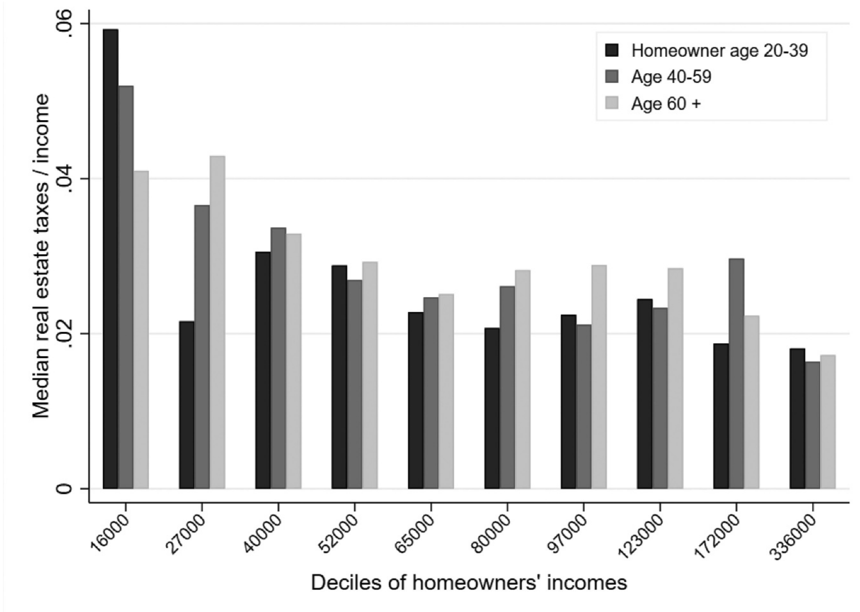

Figure 4. Property taxes as a share of income. See notes for Figure 2.

homeowners younger than 40, property taxes are largest as a share of net worth, rising to above 2% for middle-income, younger homeowners. On average, property taxes amount to a wealth tax that is steepest for younger, less affluent homeowners.

We typically think of tax burdens as a share of income, not as a share of wealth, so Figure 4 plots the data that way. The 10% of homeowners with the lowest incomes pay nearly five percent of their incomes in property-wealth taxes. The richest 10% pay less than 2%. Either way, by wealth or by income, property taxes are regressive. And seen this way, by income, there's very little difference among the age groups. Less affluent homeowners pay higher property taxes as a share of their incomes, and richer homeowners pay less, regardless of their ages.

II. Other issues: federal tax deductions, renters, and US presidential politics

Until 2017, when the US Congress passed the Tax Cuts and Jobs Act, a third issue made property taxes even more regressive. American taxpayers could choose either to deduct a standard amount (12,700 USD for a married couple in 2017) from their income before taxes were applied, or to itemize various categories of deductions including property taxes. High-income homeowners, who faced the highest 39.6% top marginal income tax rate, were typically better off itemizing. That meant every dollar of local property taxes they paid would be offset by a 39.6 cent reduction in their federal income tax bills. That is an effective tax subsidy of nearly 40% for high-income homeowners. For lower-income homeowners, who faced lower federal tax rates, that effective subsidy was smaller. Every dollar of local property taxes paid would be offset by some lower amount. And homeowners who didn't itemize paid the full cost of local property taxes.

The 2017 Tax Act eliminated much of that advantage for high income property tax payers. It doubled the standard deduction, so fewer taxpayers itemize. And it capped the allowable deduction for state and local taxes, including property taxes, at 10,000 USD.

A different distinction needs to be drawn for renters. They do not pay property taxes directly, but their landlords do and surely pass along some portion of those taxes to their tenants in the form of higher rents. How much they pass along has been debated since the days of Adam Smith and David Ricardo without settlement. England (2016) reviews the evidence.

The degree to which property taxes are borne by renters depends on, among other things, the relative elasticities of housing supply and demand, and the degree to which the local benefits funded by tax revenues are capitalized into rents. Empirical work on the topic is difficult and scarce. Here's one example. Tsoodle and Turner (2008) show that a 0.34 percentage point increase in property taxes (one standard deviation) is associated with annual rent increases of 425 USD (relative to average annual rents of 7,300 USD). That suggests renters bear the bulk of the property tax burden, because 425 USD is 0.34% of 125,000 USD, a not unreasonable assessed value for an apartment that leases for 7,300 USD per year. If Tsoodle and Turner are correct, then America's property-wealth taxes are even more regressive than depicted by Figure 4, which omits renters.

Several candidates for the US presidency in 2020 proposed new federal taxes on wealth. One would have imposed a 2% annual tax on household net worth over 50 million USD, with higher rates for net worth above 1 billion USD. Opponents claimed that "the US has never had a wealth tax,"[5] calling the idea "confiscatory,"[6] "punitive,"[7] and "unfair."[8] But as this note shows, state and local governments in the US have long levied wealth taxes in the form of property taxes. For the median American homeowner, those property taxes amount to an 0.86% wealth tax. That is lower than the proposed 2% rate, but it applies to millions of middle-class families, not just those with over 50 million USD. And the rates are regressive, imposing larger burdens on younger homeowners with fewer assets and lower incomes.

Disclosure statement

No potential conflict of interest was reported by the author.

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