

Truth-in-Taxation: The Guide to How Property Tax Rates Are Set

Texas property owners are faced with a near certain fact—year in and year out, their property tax bills will go up. Rising appraisals usually get the blame, but in fact, whether their taxes will go up depends on the tax rates adopted by their local governments—cities, counties, school districts, and special districts. With Texas now drifting into summer, most property value appeals have been concluded. But the real determination of whether taxes will rise or fall depends on the local government budgeting process which is just now starting. Unlike all other taxes, property tax rates are not fixed—they must be set each year as a part of each taxing entity's budget process (just as most properties are reappraised every year). Taxpayers do have certain protections, but they are not meant to be a substitute for active involvement in the local budget process.

Texans don't like property taxes. Their property tax bills are high and continue to go up even when their ability to pay doesn't; the amount they pay is based on what someone else estimates their property is worth, which goes up even when no improvements are made; and they pay taxes every year, over and over again on the same asset!

The local appraisal district that appraises their most cherished possession—their home—is an entity largely unknown to them. Property owners can protest their property's value, but the process often seems unfriendly and biased against them. The tax rates that apply to their property must be publicized beforehand and adopted in a public meeting, but since they often pay taxes to as many as half a dozen taxing entities, participation in the rate setting process can be a confounding proposition at best.

But as seemingly mysterious as the process is today, it used to be much worse. Prior to the "Peveto bill" of 1979,¹ that created the modern property tax system cur-

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rently in place, property was valued separately by each taxing jurisdiction. Property owners often found that the city valued their property at a different amount than the county did, which in turn may have been different from the value assigned by the school district. And it wasn't just a minor difference of opinion—values and tax rates varied widely from one local governmental entity to another.

To bring order to the chaos, the "Peveto bill" created a uniform and professional system of appraisal across the state. Property owners now get a single appraisal—based on the determination of the market value of their home by professional, licensed appraisers employed by their county's central appraisal district. That appraisal must be used by all entities authorized to levy a tax on the property. Property owners who question the value assigned to their property, can appeal first to their appraisal district, and then to an independent appraisal review board. If the property owner is still not satisfied, an appeal can be filed with the State Office of Administrative Hearings, provided the property is valued at more than \$1 million, or file suit in district court challenging their property's appraised value, although most tax bills may not be high enough to justify the expense of litigation.

¹Senate Bill 621 enacted by the 66th Legislature during the 1979 regular session. Though authored by Senator Grant Jones, the catalyst for the legislation was Representative Wayne Peveto, and the bill is commonly referred to as either the "Jones-Peveto bill," or more simply, the "Peveto bill."

Importantly, the appraisal of property is only one part of the property tax equation. The actual amount of taxes due depends on the tax rates that local elected officials adopt. To make the process of determining tax rates more transparent, the Peveto reforms mandated a “truth-in-taxation” process (commonly abbreviated as “TNT”) to:

- Enable taxpayers to readily see how their property is being taxed,
- Knowledgeably participate in each taxing entity’s rate-setting process, and
- Limit excessive tax increases.

In large measure those goals have been realized and taxpayers now have the opportunity to be far better informed than before the Code’s adoption; however, over time the calculation of key elements of the TNT construct has become complicated and difficult to follow.

TNT in a Nutshell

An essential component of the budget and tax rate adoption process is obviously the amount of tax base to which the rate will apply. The appraisal district calculates each property’s value as of January 1. After all taxpayers have been given a chance to review and, if necessary, protest their values, the appraisal district forwards a final certified tax roll to each taxing jurisdiction by July 25. The taxing jurisdictions then crunch their budget numbers and, in compliance with the “Truth-in-Taxation” requirements, adopt the tax rates needed to fund their budgets for the upcoming fiscal year, which typically begins either September 1 or October 1. The taxes due, for example, on the taxable property values as of January 1, 2015 (the 2015 tax year), will be collected and used to fund the taxing jurisdiction’s 2016 fiscal year.

The tax rate the jurisdiction desires to adopt to finance its upcoming budget is its “proposed” tax rate. To determine whether a property owner’s taxes will go up or down, TNT requires a jurisdiction other than a school district to provide benchmarks against which the proposed rate is to be compared:

- Effective Tax Rate (ETR) is essentially the tax rate that, when applied to the upcoming year’s tax base, would raise the same amount of tax revenue as in the current tax year. The calculation includes only properties that were on the tax roll in both the upcoming and current year; any new property or any property removed from the tax rolls is excluded from the calculations. If a jurisdiction adopts a tax rate higher than the ETR, property owners overall will pay higher taxes; if the jurisdiction adopts a tax rate lower than the ETR, property owners will pay less in taxes.

- Rollback Tax Rate (RTR) is the rate that, if applied to the upcoming year’s tax roll (again, adjusted for new and lost properties), would increase total property taxes for maintenance and operations by 8 percent (a level set in statute). If a jurisdiction adopts a tax rate that exceeds the RTR, voters can petition to require an election be held to “rollback” the adopted tax rate. “Rollback” may be a misleading term, though, because if the election is successful, the proposed tax rate is reduced to the rollback tax rate, which still results in an eight percent tax increase on all previously-existing properties.

Somewhat different requirements for calculating tax rates, public notices and hearings, and tax rate adoption apply depending on the type of local government.

The Detailed Math Behind Truth-in-Taxation

The ETR Calculation

The starting point is the taxing unit’s total tax roll value for the upcoming fiscal year as certified by the Central Appraisal District (CAD). A number of adjustments to both that figure and current tax roll values are required to arrive at the portion of the certified value related to property on the roll in both years.

Subtracted from the current year’s total value are:

- Value of homesteads with tax ceilings for elderly or disabled homeowners,
- Value lost due to court decisions,
- De-annexed property values,
- Value lost because of first-time exemptions, and
- Value lost on property that first qualifies for agricultural or other special use valuation.

These adjustments are intended to result in an “apples-to-apples” comparison of property that was on the tax roll in both the prior and current year.

The resulting adjusted value is multiplied by the current year’s tax rate to arrive at an adjusted tax levy figure. From this a jurisdiction may deduct tax refunds and taxes paid into a tax increment financing fund (moneys dedicated for a specific use that are not available for general purpose spending). The resulting tax levy figure becomes the tax revenue baseline to which the upcoming year’s levy will be compared.

The next step is to adjust the upcoming year’s total certified value by subtracting:

- First-time exemptions for pollution control properties,
- Captured value in a tax increment financing

- zone,
- Value of properties under protest or not certified,
- Value of homesteads with tax ceilings,
- Annexed property values, and
- Value of new improvements and business personal property.

The ETR is then derived by dividing the current year's adjusted tax levy by the upcoming year's adjusted value.

The ETR calculation includes both the district's maintenance and operations taxes AND its interest and sinking (debt service) taxes. Debt service payments used to retire the district's bonded indebtedness are generally fixed, while a jurisdiction's tax base usually grows over time. Consequently, the rate of tax necessary to service a jurisdiction's debt typically falls over time. By including the debt service tax rate as a part of the ETR calculation, a jurisdiction can essentially increase its taxes for maintenance and operations without it being counted as a tax increase under truth-in-taxation.

The RTR Calculation

The Rollback Tax Rate, or RTR, for jurisdictions other than school districts is the maximum tax rate a jurisdiction may adopt without being subject to a voter petition to require an election to "rollback" the tax rate to the RTR. As with the ETR, the calculation is lengthy and complex.

An adjusted maintenance and operations (M&O) levy for the current year is calculated by multiplying the current M&O tax rate by the current year's adjusted value. That amount is adjusted by:

Adding:

- Additional sales tax revenue spent for M&O,
- Cost of a governmental function received from another entity,
- Refunded taxes,
- Increased expenses for indigent health care,
- Amount spent by counties for housing state prisoners,

And subtracting:

- Cost of a governmental function discontinued or transferred to another entity,
- Amount paid into a tax increment fund.

The resulting adjusted tax levy figure is divided by the upcoming year's adjusted value to arrive at an effective M&O rate which is increased by 8 percent to arrive at the rollback M&O rate.

A debt rate is calculated for inclusion in the total RTR. It is based on the scheduled debt service payments for the upcoming budget year necessary to fund outstanding voter-approved bonds. Any excess debt service taxes collected in the previous year are to be credited against the upcoming year's debt service liability, as are any amounts to be paid from non-property tax revenues. This adjusted amount is then multiplied by a collection ratio—the jurisdiction's estimate of the percentage of taxes due it believes will actually be collected. Should a higher amount of debt service tax revenue actually be collected in the upcoming year, the excess is to be credited against the next year's debt service requirement. Dividing the adjusted amount of debt service taxes by the coming year's total certified value yields a debt service rate. This is added to the rollback M&O rate to derive the total RTR.

TNT rate calculations were much simpler when first adopted in 1979. Over time, rate calculations have been made much more complicated by the addition of adjustments to offset the cost of certain mandated expenditures or revenue dedications. What began as a fairly uncomplicated calculation is far from that now. The Comptroller's Office provides resource documents for taxing jurisdictions to assist them through the TNT process. The explanatory guide for cities, counties, and special districts is nearly 50 pages. The worksheets to calculate the effective tax rate cover four pages and involve more than two dozen separate entries. The worksheets to calculate the rollback tax rate may add another four pages and two dozen additional entries.

Tax Rate Adoption

Notices of proposed tax rates must be either published in a newspaper with general circulation in the taxing jurisdiction or sent individually to each taxpayer. The jurisdiction must hold two public hearings before it may adopt a rate that exceeds the ETR (only one hearing is required for school districts and water districts).

Not less than three days or more than 14 days after the second hearing, the jurisdiction may adopt its tax rate in a properly posted public meeting. The motion to adopt a tax rate in excess of the ETR must specifically state:

I move that the property tax rate be increased by the adoption of a tax rate of (specify tax rate), which is effectively a (insert percentage by which the proposed tax rate exceeds the effective tax rate) percent increase in the tax rate.

Rollback Process

If a city, county, or special district adopts a tax rate that exceeds the RTR, voters may petition for an election to "rollback" the tax rate to the rollback rate (i.e., an 8 per-

cent tax revenue increase). A petition with the prescribed number of signatures must be submitted within 90 days of the date of the tax rate's adoption. The required number of signatures is either 7 or 10 percent of the registered voters in the governmental entity, depending on whether the taxes imposed would exceed \$5 million.

For example, if the state's largest county, Harris, adopted a tax rate subject to rollback, taxpayers would have 90 days to gather over 147,000 signatures (7 percent of registered voters). More than 99,000 signatures would be required in the City of Houston, 44,000 in the City of Dallas and 85,000 in Dallas County.

Given the relatively short time frame within which voters may petition for a rollback election, and the extremely high threshold of signatures necessary, the accuracy of the taxing jurisdiction's calculations and the veracity of required public notices is absolutely essential.

Rollback elections are, however, a rarity. Some attribute that to the difficulties associated with the petition process; others may attribute it to the community's acceptance of higher taxes. In 2013 and 2014, at least 148 of Texas' 1,200 cities adopted tax rates that exceeded the 8 percent rollback limit.² There were no successful petitions and no rollback elections. Over that same two-year period, 50 of Texas' 254 counties adopted tax rates in excess of their rollback rates. Only one petition was successful, and the subsequent election reduced the county's adopted tax rate to the rollback rate.

School districts are subject to an entirely different process—the result of school finance reform legislation enacted in 2006. A school district's board of trustees has the authority to levy a tax rate for maintenance and operations up to a \$1.04 limit. Any M&O tax above that, up to an allowable maximum of \$1.17, automatically triggers a "tax ratification election," or TRE, meaning that voters must always be asked to affirmatively approve the higher tax rate.

Since the automatic school tax election provisions took effect, 560 of the state's 1,000 plus independent school districts have asked voters to authorize an M&O tax rate in excess of \$1.04. Voters in 422 of those districts—75 percent—have approved the higher tax rates.

Has Truth-in-Taxation Protected Taxpayers Against Rising Property Taxes?

The property tax is unpopular for many reasons, some of which have already been discussed. It is highly visible—especially to those who do not escrow—due in

one lump sum year in and year out. It seems to increase each and every year, whether times are good or bad. And though a local tax, some of the entities listed on one's property tax bill seem foreign—such as municipal utility districts, groundwater conservation districts, levee improvement districts, navigation districts, county development districts, drainage districts, or even a mosquito control district.

There is no question the system is greatly improved under the Truth-in-Taxation reforms of the Peveto legislation. But why is there a perception that property taxes are out of control, and why are they still such a hot button political issue?

A handful of reasons directly related to Truth-in-Taxation may provide answers.

1. **Median Incomes are Lagging Property Tax Increases.** As local property taxes have grown in the aggregate, so too has personal income.

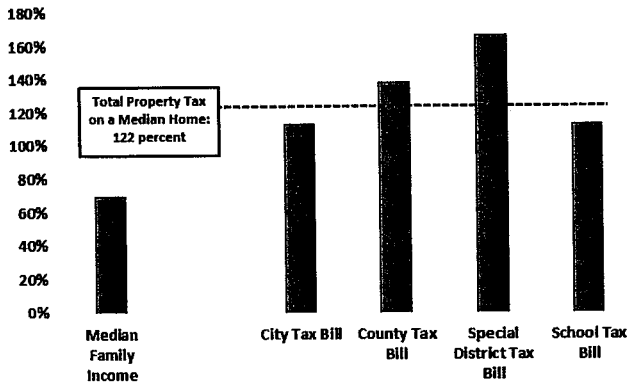
Since 1994, personal income in total has increased 244 percent in Texas, while total property taxes have increased 218 percent (sales taxes, by comparison, have increased 190 percent). However, absent legislative efforts to reduce school property taxes in 2006 and 1999, property taxes would have increased 270 percent—well above the growth in personal income. The gap between personal income and property tax bills doesn't, at least on the surface, appear to be a huge disparity—perhaps roughly half a percent per year—but overall numbers don't necessarily illustrate what the average property owner is experiencing. They don't necessarily see trends happening across the state, but are keenly aware of what is happening on their personal tax bill, and how that relates to their ability to pay it.

Though total personal income statewide has increased substantially over the past 20 years, median family income has grown by only 70 percent. In contrast, the total property tax on a median-valued home has increased 122 percent. Property taxes levied by every single type of jurisdiction statewide over the past 20 years have increased faster than median family income, led by those levied by special purpose districts—up 166 percent (**Figure 1**).

2. **Low Inflation has Effectively Increased the Rollback Limit.** When the Legislature first implemented TNT as a part of the 1979 property tax overhaul, the rollback limit was set at 5 percent. At the time, inflation was rampant—well over 10 percent. With inflation eating away at the value of their

² Of the 1,200 Texas cities, 135 failed to report tax rate information to the Comptroller, so it cannot be determined whether their adopted rates exceeded their rollback rates.

Figure 1
Texas Median Family Income and Household Property Taxes
Increase from 1994 to 2014

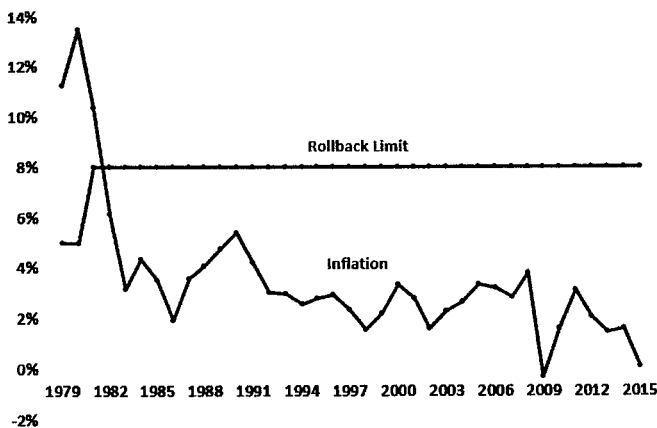


Source: U.S. Census Bureau and Texas Comptroller of Public Accounts

tax revenues, local governments complained that the 5 percent limit was far too restrictive. In response, the Legislature promptly increased the rollback limit to its current 8 percent, anticipating that inflation would continue to be high. Instead, it dropped into the single digits, and has been well below the 8 percent threshold for the past 30 years. Low inflation has essentially provided taxing jurisdictions with substantial room to increase taxes without being subject to rollback (Figure 2).

3. A Large Part of Local Value Growth is Excluded from Limits. The value of any new property on tax rolls is excluded as a way to recognize that jurisdictions will incur additional costs to provide public services to the new property. In this way, rapidly

Figure 2
Texas' Property Tax Rollback Rate Versus Inflation
1979 to Present



Source: U.S. Bureau of Labor Statistics

growing jurisdictions are not unduly limited in being able to finance their costs associated with growth. Typically, this allows most jurisdictions access to some amount of additional revenue growth above the 8 percent rollback rate, although this number will obviously vary with local conditions.

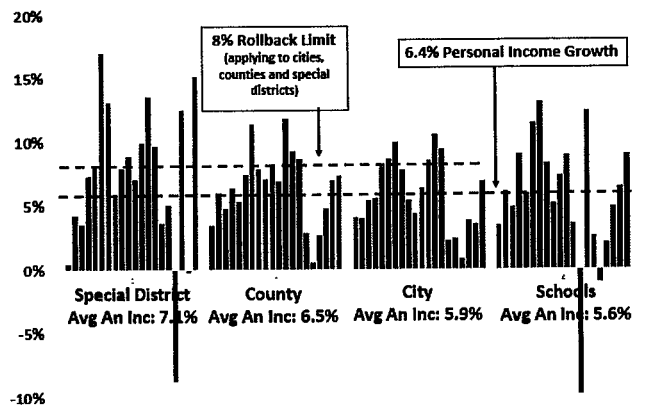
Another factor is the growing use of tax increment financing zones (TIFs). A jurisdiction may designate a particular area within its boundaries as an increment zone. The growth in property value within the zone is excluded from a jurisdiction's overall value growth for purposes of calculating its effective and rollback tax rates and any taxes collected on that incremental value is dedicated to funding specific purposes. Initially designed as a way to pay for special purpose needs, such as urban renewal or transportation financing, evidence is emerging that jurisdictions may be abusing these districts as an indirect way of raising general tax revenues while technically staying under their rollback limits.

Data from the past 20 years illustrates that across the state, property taxes have regularly exceeded the 8 percent rollback limit: 9 times for special districts, 5 times for counties, and 5 times for cities. In even more years, local levies far exceeded the average rate of personal income growth (Figure 3).

4. Oversight is Lacking. A property owner can seek an injunction to stop the taxing unit from issuing property tax bills if they believe a jurisdiction has failed to properly comply with the hearing, notice or

Figure 3
Annual Growth in Texas Property Tax Levies
1994 to 2014

Note: Bars reflect annual percent change. School districts data reflects 2006 tax relief initiative. Special district data is as reported.



Source: Comptroller of Public Accounts and U.S. Bureau of Labor Statistics

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tax rate adoption requirements; however, the law does not explicitly provide for ensuring the accuracy of the numbers used in the process.

While Texas law itemizes the various elements of the truth-in-taxation calculations in great detail, and while the Comptroller provides very detailed instructions, it largely falls to the taxing jurisdictions themselves to police compliance.

There is no independent oversight of a taxing jurisdiction's calculations. State law does not require the chief appraiser to verify all the property value numbers a jurisdiction uses in its calculations, nor is the county auditor required to verify the budget figures used. That job falls to taxpayers who are ill-equipped to critically evaluate a taxing unit's calculations. If taxing units don't do it correctly, taxpayers unknowingly can wind up paying more taxes than they should have.

Conclusions

The truth-in-taxation process has provided a much needed system of checks and balances in the setting of property tax rates by local taxing entities, but it does not provide automatic protections. For TNT to effectively impact property taxation, concerned taxpayers must do more than protest their appraisals. They must engage in the rate setting process to meaningfully communicate their position on proposed property tax actions. To that end, however, it is essential that the relevant information they are provided is accurate and reasonably understandable; otherwise taxpayers may not be able to fully exercise their rights.

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