

# BRIEFINGS



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## Amendment 1 on Property Taxes is Not True Reform and is Likely to Do More Harm than Good

On January 29, 2008, Florida voters will consider a proposed property tax amendment to the Florida Constitution. This amendment is the result of two years of legislative struggle and debate over the complex issue of property tax reform. There is no more debate as to whether or not Florida's property tax system needs reform, but there is plenty of debate about how to do it.

Unfortunately, the Legislature's need to pass something "people will vote for," coupled with a sincere desire to help Floridians who cannot afford to move because of higher taxes, resulted in a proposal that is not only unsatisfactory but also likely to be detrimental. Giving a larger cut to homeowners became more important to legislators than actually reforming the property tax system. But doing what is popular is not always doing what is right. As a result, voters now must consider a proposed amendment that not only does not target relief to those who need it most, perpetuates an inequitable system and exacerbates the tax shift to those taxpayers who have suffered the most. Not to mention that the portability provision of the proposed amendment may well run afoul of the United States Constitution, according to the expert legal advice commissioned by the Legislature.

One of the benefits touted by proponents is the hope that the portability provision will stimulate the economy by jump-starting the housing market. It is true that there will likely be a limited benefit by making it more attractive from a tax perspective for people to move. However, the specter of the long-term harm to Florida's economy by continuing a system that shifts billions of dollars in tax burden to businesses, renters, second homeowners and snowbirds overshadows any short-term benefit.

Passage of the amendment could also end the hopes of future comprehensive property tax reform.

The new plan includes:

- Save Our Homes portability, up to \$500,000; applies to all levies.
- Increasing the \$25,000 homestead exemption to \$50,000, except the new exemption does not apply to school taxes, which comprise approximately 40% of property taxes.
- Tangible personal property exemption of \$25,000 for businesses; applies to all levies.
- 10% cap on assessments for non-homestead property; does not apply to school taxes.

The statutory implementing bill for the amendment requires the state to appropriate state funds annually to reimburse fiscally constrained counties for any revenue lost from this proposal.

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*"Improving taxpayer value, citizen understanding and government accountability."*

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It is claimed this will save taxpayers \$9.3 billion over five years. It is expected to save the average homeowner about \$240 from the homestead exemption, with greater savings coming to people who move from the portability provision.

### **The new property tax amendment falls far short of what is needed. There are a number of reasons why:**

- The plan gives most of the relief to those who need it the least (long-term Save Our Homes property), while giving very little to those that have seen their taxes rise the most (non-homestead property).
- It will perpetuate the current system and exacerbate the shift of tax burden from homestead to non-homestead property. It will also continue to shift tax burden to new homeowners.
- While some solution to portability is needed, there are serious constitutional concerns about providing it.
- The 10% cap for non-homestead property is so high as to be of little value to most properties.
- The \$9.3 billion five-year taxpayer savings estimate is likely overstated. The proposal does not restrict local governments' ability to increase millage rates to recoup revenue losses, thereby lessening the savings for some and shifting more tax burden to others.
- And perhaps most importantly, if the voters approve this new amendment, future attempts to reform non-homestead property taxes will be extremely difficult.

These issues are explained in more detail below:

**Who Gets Relief?** The tax burden of the average Florida homeowner was not a big issue when this property tax debate started a couple of years ago, and rightly so. Save Our Homes has held down the annual assessment growth of each homestead property to 1.6% to 3.0%. Because property values have risen so fast, and non-homestead property assessments are not capped, local governments have been able to lower millage rates and still bring in significant new revenue. This situation has allowed homesteaders to enjoy very small annual increases, and even decreases, in their tax bills. A report by the Legislature's Office of Economic and Demographic research found that Save Our Homes has had the effect of "producing real tax bills that are lower today than they were in 1994 for those homesteads that have been protected since then, assuming adjustments for inflation."

So, who has paid for the doubling of total property taxes in our state in the last six years? It has been mostly non-homestead property. So, who gets the relief under this proposed amendment? **Of the estimated \$9.3 billion in estimated five-year savings, nearly 80% goes to homestead property owners.** More than half comes from the increased homestead exemption alone. Consider that homestead property makes up only one-third of the state's total tax roll, and the disparity is even more striking.

The amendment does include a very good provision that Florida TaxWatch has recommended for years. There is broad consensus on the merits of the \$25,000 exemption from the tangible personal property taxes that businesses pay. While this may help small businesses cope with the large property tax increases they have experienced, the approximately \$450 average maximum savings is a drop in the bucket for many businesses. Complying with the law creates a lot of work for both the public and private sector with (in the case of small businesses) relatively little return. While this provision is a welcome

change, it is really more about tax administration than tax reform. The Legislature should consider an even larger exemption or indexing it to inflation. Florida TaxWatch has confidence this will happen in the near future even if this amendment fails.

**Continuing the Tax Shift.** It must be remembered what this property tax crisis is really about. Florida TaxWatch has been examining and issuing reports on this current crisis for more than two years. The problem has always been that Save Our Homes (SOH), coupled with unrestrained local government spending, has created inequities and has greatly increased taxes on only a portion of the state's taxpayers. It is the non-homesteader—landlords and renters, businesses, second and vacation homeowners, snowbirds and even homesteaders who also own non-homestead property—who has shouldered the burden of increasing property taxes.

Save Our Homes reduced the taxable value of homesteads by \$404 billion in 2006 and by over \$1 trillion since 2000. This reduction is worth more than \$20 billion in taxes. Assuming SOH did not cause local governments to lose money, most of the \$20 billion was shifted to non-homestead property and new homebuyers. This is a safe assumption since total property tax levies in Florida have doubled in just six years. In fact, a good argument can be made that SOH has insulated most homeowners from tax increases, thereby removing a significant source of pressure on local governments to cut millage rates further.

The amendment would perpetuate and exacerbate this tax-shifting system. **Further reducing the taxable value of homesteads will further burden the most burdened.** The addition of portability (see below) will mean that most Florida homeowners will be assured their SOH savings will grow forever, instead of having their homes assessed at full value when they move. While this is good for homesteaders, it is more bad news for non-homesteaders. And while the increased homestead exemption will help, this system will continue to shift burden to new homeowners as well.

The Florida Legislature commissioned a group of researchers from the University of Florida and Florida State University to examine the state's property tax system and the effect of proposed changes. One of the findings of the report *Analytical Services Relating to Property Taxation* was: "The statewide reduction in the taxable value of real property due to portability would be approximately \$27.5 billion in 2007 and increases to between \$143 billion in 2012 and \$253 billion by 2017. Portability increasingly shifts the tax burden from longer-term residents to newer, less affluent, homeowners and to non-homestead properties."

The previous proposed amendment, originally considered at the start of the Special Session on property taxes in October 2007 and later replaced by the current proposal, did at the very least have the benefit of slowly phasing out SOH without significantly harming most homesteaders.

**Constitutional Concerns with Portability.** The lack of portability—not being able to take SOH savings with you when you move—is another serious problem created by SOH. While some solution is warranted, there are serious constitutional concerns about providing it. During the legislative debate, supporters said they "believe" it will pass muster in the courts if challenged, but conceded the question is not answered.

In 2006, the Florida Legislature hired a team of distinguished state and local taxation law attorneys from the law firm of Sutherland, Asbill & Brennan, LLP, headed by Walter Hellerstein—one of the foremost legal experts on the taxation law—to analyze the constitutionality of several Save Our Homes-related proposals. The report concludes that portability will almost certainly result in expensive litigation, as it will be challenged on a number of meritorious constitutional grounds, including the Commerce Clause, the "Interstate" Privileges and Immunities Clause, and the constitutionally protected right to travel. **Furthermore, the report's analysis of U.S. Supreme Court precedent on these issues indicates that**

**at least one of these challenges could be successful, resulting in the portability provision being stuck from the Florida Constitution.** These findings seem to have been forgotten.

It has even been implied that some of the legislative support for including portability is that it is seen as a way to potentially get Save Our Homes thrown out by the courts. A lawsuit was filed in Leon County Circuit Court in November that seeks repeal of Save Our Homes due to the unequal treatment of long-time homeowners versus new residents. **Portability would increase the scope and the magnitude of that disparity and thereby increase the chances of a successful challenge on federal constitutional grounds.** While the repeal of Save Our Homes has merit, doing so without a replacement system that does not cause immediate massive tax increases on homeowners would be very troublesome. Moreover, a ruling that certain parts of the Save Our Homes Amendment are unconstitutional would likely result in a court remedy that could, among other potential redresses, require billions of dollars to be paid by the state to those who have not benefited from SOH, and would, at any rate, likely cause the state to be involved in litigation concerning the remedy for years to come at all the taxpayers' expense.

"I predict with 100 percent certainty there will be a lawsuit," Hellerstein was quoted as saying in the *Orlando Sentinel*. "It will be years before we know [the outcome]. If I were a legislator, I would not have supported a constitutional amendment that in my judgment would put the state treasury at some risk."

A better approach to portability—and a concept supported by Florida TaxWatch—was also debated by the Legislature. This approach is a 40% minimum exemption for all homeowners that is phased out as SOH savings increase. While not providing true portability, it would assure that someone who moved would immediately have 40% of their home's value shielded from taxation, the same amount as a new homebuyer or someone who moves to Florida from another state.

**Non-homestead Property Assessment Cap.** Simply put, the 10% cap for non-homestead property is so high as to be of little value to most properties. The average annual growth in the total value of non-homestead properties, both historically and forecasted for the next five years, is about 5%. This growth includes new construction, so the "average" growth per property would be even less. And since school taxes are not covered under the cap, it only applies to approximately 60% of the average tax bill.

It could help some properties with extraordinary spikes in value, but even that help could be short-lived. If a covered property's just value does not rise as much as the cap, the assessment can still increase 10%, as long as it does not exceed just value. For example, if a property's value increased 15% one year, its assessment for 60% of its tax levies would only go up 10%. But if that property's just value increased only 5% the next year, it would be assessed at full value, and last year's savings would be lost. Many homeowners are experiencing this phenomenon this year with SOH—a decrease in their home's value still means an assessment increase. **It will be very hard for the vast majority of non-homestead properties to accumulate any savings.**

Proponents of the amendment having been saying that this "assures businesses that their taxes can't go up by more than 10%." This is not the case. For one thing, the cap only applies to 60% of the average tax bill. Additionally, increased millage rates could also result in a tax increase of over 10%.

**What About Millage Rates?** The Legislature left out a critical provision from the statutory implementing bill (SB 4D) for the amendment. To ensure that more tax burden is not shifted to non-homestead properties, and to ensure that local governments truly absorb the cost of the increased homestead exemption and portability, the statutory millage cap (passed in the 2007 regular session) must be amended. This can be done by requiring that the rolled-back rate be calculated before the value of these exemptions is removed from taxable value. This missing important language was included with

other constitutional proposals that were considered and is essential to ensuring that these are true tax cuts and not tax shifts.

The rolled-back rate is the millage rate that would raise the same amount of revenue on the new year's tax roll (minus new construction) as was raised the previous year. Local governments are required to calculate this rate, and it should be used as the starting point for budget deliberations (although in practice, it seldom is). Any proposed rate over the rolled-back rate must be advertised as a tax increase.

Without this safeguard, the rolled-back rate calculated by local governments will be higher than it would have been; it could even be higher than the jurisdiction's current rate. This rate could be proposed without local governments even advertising the rates as tax increases to its citizens.

While it is likely to be politically difficult to pass a significant millage increase next year, it would be possible for a government to raise the millage rate high enough to recoup all of the revenue with only a simple majority vote (provided they have room under the 10-mill cap). In fact, the statutory millage cap allows a local government to adopt a rate that equals the rolled-back rate plus the growth in per capita personal income with a simple majority.

**While there will be pressure to keep millage rates down, some governments will surely adjust rates to recoup at least some of the taxpayer savings.** Local governments lobbied for this provision to be left out. This omission means that the \$9.3 billion five-year taxpayer savings estimate is likely overstated.

**Making True Reform Even More Difficult.** Perhaps most importantly: If voters approve this new amendment, future attempts to reform non-homestead property taxes will be extremely difficult. This amendment provides two major benefits to homestead properties—portability and an increased homestead—on top of the millage cap and rate reductions already passed statutorily. It is extremely important to acknowledge that providing more benefits to homesteaders and attempting to fix problems Save Our Homes created for them, **makes it much more difficult to create a future constitutional amendment to help non-homestead property that would garner enough voter support to pass.**

Since any changes to help non-homestead property will likely put upward pressure on homesteaders' tax burden, Florida TaxWatch has recommended that these and other homestead benefits should be part of a comprehensive property tax relief and reform proposal that has "something fair and equitable for everybody." Legislators have said they will "come back and try to do something for non-homestead property," but such proposals, by themselves, will have a tough time garnering the necessary 60% voter approval.

## Florida Can, And Must, Do Better

Florida TaxWatch has been documenting the problems with our property tax system ever since Save Our Homes was proposed in 1992. Over the past two years, our research program has been focused extensively on property tax reform and local government spending.

We have stayed true to our "*Guiding Principles for Property Tax Reform*" (see appendix A), many of which this amendment violates. We have strived to promote a system that is fair and affordable for all. The amendment does not achieve that goal.

It is telling to listen to the experts the Florida Legislature paid more than half a million dollars to examine property tax issues. We have already included the warning of the legal expert about the dubious federal constitutionality of portability. The State has not refuted that assertion. Florida TaxWatch also asked

some of the economists who authored the other aforementioned legislatively commissioned report on property taxes for their view of the amendment.

Two Florida State University professors, David Macpherson, Ph.D., Rod and Hope Brim Eminent Scholar of Economics, and Director, Pepper Institute on Aging and Public Policy and Dean Gatzlaff, Ph.D., Chair and Mark C. Bane Professor in the College of Business offered this summation: “Save Our Homes has caused dramatic property tax inequities among Florida’s property owners. Our analysis suggests that the proposed amendment will make a bad situation worse. We cannot find a sound economic argument to support the amendment.”

David A. Denslow, Jr., Ph.D., Distinguished Service Professor, Department of Economics, University of Florida, and Research Economist, Bureau of Economic and Business Research stated in part: “These possible gains (of portability) are more than offset, in my view, by serious flaws. Most importantly, the amendment perpetuates inequity by allowing those who benefited the most to continue to be the lucky winners, carrying their gains with them. Without portability, the unfairness would shrink more rapidly as the housing boom fades into history.” He concluded: “Though the amendment is a noble effort and would alleviate some of the symptoms of Save Our Homes, it is a cure worse than the disease.” (for the full text of Dr. Denslow’s comments, see Appendix B.)

The Legislature or the Taxation and Budget Reform Commission can come up with a better plan. Other proposals have surfaced that display a better grasp of the real problems and how to address them.

Florida TaxWatch acknowledges that the replacement of Save Our Homes with a better system, even with added benefits and safeguards for homeowners, is a long shot at this time. We have recommended another approach—institute a “Save Our Taxpayers” system. This system would cap the assessment growth of all property, the same way Save Our Homes does for homesteads. The cap for non-homesteads could be a bit higher than the 3% for homesteads, possibly 4% or 5%. A significant minimum exemption, such as the 40% considered by the House, should be added that would be phased out, dollar for dollar, as Save Our Taxpayer savings grow. This exemption will help avoid a large tax shift to new construction and new buyers and provide a measure of portability.

Hearing from disgruntled taxpayers is nothing new for Florida TaxWatch, but during the last two years, the volume of calls and magnitude of taxpayers’ anger reached a fever pitch. Taxpayers perceive a property tax system that is unfair, unaffordable, out of control, and getting worse. With the exception of portability issues, we did not hear from the taxpayers who are receiving the lion’s share of the amendment’s savings. Most of the people from whom we heard will not get much relief and will continue to be stuck with a property tax system they judge to be out of control.

It will be hard for voters/homeowners to reject a proposal that cuts their taxes even a modest amount. But they need to weigh that against the negative effect the property tax system can have on our economy, competitiveness, and quality of life. Florida may be experiencing a major change. Net migration into our state is slowing and robust growth may no longer be something that can be taken for granted. Property taxes are likely one cause of this, along with casualty insurance and the mortgage crisis, as well as yet unidentified factors.

Voters must acknowledge there is no such thing as a free ride. Unfair taxes on one group of taxpayers have ramifications for all taxpayers. Businesses, whenever possible, will pass along the higher property taxes they pay through increased prices of their goods and services purchased by all Floridians. Those businesses that cannot, and those renters and part-time residents that cannot, will be priced out of doing business or living in Florida. The loss of businesses and jobs is certainly harmful and the loss of part-time residents must be considered as well. Snowbirds have always been a good deal for Florida taxpayers since they pay full-time taxes but use far less services. Losing them can increase the tax burden on all

homestead residents. Continuing to shift an ever-increasing tax burden onto non-homestead property taxpayers under this amendment can lead to the proverbial “killing the goose that laid the golden egg.”

This amendment is being called a “first step” to property tax reform. In reality, passage of this amendment could be the end of hopes for real system-wide reform and help for non-homestead property. Florida voters should reject Amendment 1 and demand real property tax reform.

## **Florida TaxWatch Guiding Principles for Property Tax Reform**

- Homestead property owners (voters), should retain a stake in property taxes and feel the direct impact of the increasing cost of their local governments. This is the best way to ensure public diligence, oversight and input into taxation and spending decisions of local governments.
- Tax relief should be targeted disproportionately to those taxpayers that have disproportionately shouldered the burden of increasing property taxes.
- When considering reductions in the taxable value of one type of property, the effect that would have on the tax burden of other properties needs to be acknowledged.
- Property tax reform should reduce the current shift of tax burden from homestead to non-homestead and eliminate significant future shifts.
- Property tax reform should greatly reduce or eliminate the tax discrepancies currently existing among homestead properties. Similarly situated taxpayers should be taxed similarly.
- Property tax reform should not overly shift the burden to new construction.
- Generally, future growth of property tax revenue should not exceed taxpayers' ability to pay.
- Reductions in property taxes should not directly result in increases in other local government taxes and fees.
- To the extent possible, differences between local governments should be considered, such as how much they have increased taxes and how much fiscally capacity they have.

## APPENDIX B

### **Full Text of Dr. David Denslow's comments concerning Amendment One, as provided to Florida TaxWatch**

The interaction between the Save Our Homes amendment and the recent boom in house prices placed the Florida legislature in an unenviable predicament. The interaction created a property tax system that is unfair, that reduces economic efficiency, and that distorts local politics. The unfairness is obvious; neighbors in similar houses pay far different taxes. The economic inefficiency comes from (a) the reduced tax base forcing higher tax rates at the margin on business and other non-homestead property and (b) the lock-in effect, the tax penalty on moving. The political distortion is the incentive for longtime homesteaders, who are the bulk of the voters in jurisdictions, to be unconcerned about rising local government spending, since the higher taxes are paid by someone else.

There is no perfect way out and one must sympathize with those responsible for unscrambling the mess Save Our Homes gave us. Finding a solution that is both better than the current situation and able to win the approval of sixty percent of the voters may be impossible. To its credit, the proposal that has been created has the virtue of wiping out most of the lock-in effect, which may cause a substantial welfare loss, on the order of half a billion dollars a year. The estimate is very rough, because no one knows how many people would actually move if portability were to become available. Besides improving efficiency, portability could give the state's economy a small boost in a time of trouble.

These possible gains are more than offset, in my view, by serious flaws. Most importantly, the amendment perpetuates inequity by allowing those who benefited the most to continue to be the lucky winners, carrying their gains with them. Without portability, the unfairness would shrink more rapidly as the housing boom fades into history. Second, portability perpetuates the erosion of the tax base and the associated economic inefficiency and political distortion. Third, portability risks being found unconstitutional, violating the right to travel. (States must treat new residents the same as old.) If it is, unraveling it could be an affliction for local governments. Fourth, the "donut hole" increase in the homestead exemption and its exclusion of school taxes would make the tax system more difficult for voters to understand. It makes the system more complex. Though the amendment is a noble effort and would alleviate some of the symptoms of Save Our Homes, it is a cure worse than the disease.

#### **David A. Denslow, Jr., Ph.D.**

Distinguished Service Professor, Department of Economics, University of Florida, and Research Economist, Bureau of Economic and Business Research

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## *About Florida TaxWatch*

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Florida TaxWatch is a statewide, non-profit, non-partisan taxpayer research institute and government watchdog that over its 28-year history has become widely recognized as the watchdog of citizens' hard-earned tax dollars. Its mission is to provide the citizens of Florida and public officials with high quality, independent research and education on government revenues, expenditures, taxation, public policies, and programs, and to increase the productivity and accountability of Florida Government.

Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: in its first two decades alone, policymakers and government employees implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than \$6.2 billion -- approximately \$1,067 in added value for every Florida family, according to an independent assessment by Florida State University.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It is the only statewide organization devoted entirely to Florida taxing and spending issues. Its research and recommendations are reported on regularly by the statewide news media.

Supported by voluntary, tax-deductible memberships and grants, Florida TaxWatch is open to any organization or individual interested in helping to make Florida competitive, healthy and economically prosperous by supporting a credible research effort that promotes constructive taxpayer improvements. Members, through their loyal support, help Florida TaxWatch bring about a more effective, responsive government that is accountable to the citizens it serves.

Florida TaxWatch is supported by all types of taxpayers -- homeowners, small businesses, large corporations, philanthropic foundations, professionals, associations, labor organizations, retirees -- simply stated, the taxpayers of Florida. The officers, Board of Trustees and members of Florida TaxWatch are respected leaders and citizens from across Florida, committed to improving the health and prosperity of Florida.

With your help, Florida TaxWatch will continue its diligence to make certain your tax investments are fair and beneficial to you, the taxpaying customer, who supports Florida's government. Florida TaxWatch is ever present to ensure that taxes are equitable, not excessive, that their public benefits and costs are weighed, and government agencies are more responsive and productive in the use of your hard-earned tax dollars.

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