

HOUSE BILL REPORT

HB 2416

As Reported by House Committee On:
Finance

Title: An act relating to reinstating the one percent property tax limit factor adopted by the voters under Initiative Measure No. 747.

Brief Description: Reinstating the one percent property tax limit factor adopted by the voters under Initiative Measure No. 747.

Sponsors: Representatives Hurst, Orcutt, Barlow, Roach, Seaquist, Condotta, Kelley, McCune, Goodman, Strow, VanDeWege, Bailey, Wallace, Ahern, Green, Schmick, Lantz, Ross, Springer, Rodne, Morrell, Anderson, Rolfes, Hailey, P. Sullivan, Haler, McCoy, Hankins, Eddy, Priest, Takko, Kristiansen, Blake, Pearson, Ericks, Ericksen, Kessler, DeBolt, Appleton, Skinner, Clibborn, Hinkle, Fromhold, Warnick, O'Brien, Alexander, Campbell, Armstrong, Lovick, Newhouse, Morris, Chandler, B. Sullivan, Schindler, Eickmeyer, Crouse, Jarrett, Dunn, Kretz, Sump, McDonald and Walsh; by request of Governor Gregoire.

Brief History:

Committee Activity:

Finance: 11/29/07 [DP].

Brief Summary of Bill

- Reinstates the 1 percent regular property tax growth limit adopted by voters in Initiative 747.
- Makes the changes retroactive to and prospective from taxes collected in calendar 2002.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 7 members: Representatives Hunter, Chair; Orcutt, Ranking Minority Member; Condotta, Assistant Ranking Minority Member; Conway, Ericks, McIntire and Roach.

Minority Report: Do not pass. Signed by 1 member: Representative Santos.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Staff: Mark Matteson (786-7145).

Background:

Property Taxes - Constitutional Limitations. The property tax is the oldest of taxes in Washington and is subject to a number of constitutional and statutory requirements. The state Constitution (Constitution) requires all property taxes to be applied "uniformly;" this has been interpreted to mean that within any given taxing district, the district rate applied to each parcel of taxable property must be the same. The Constitution limits the sum of property tax rates to a maximum of 1 percent of "true and fair" value, or \$10 per \$1,000 of market value. Levies that are subject to the 1 percent rate limitation are known as "regular" levies, and there is no constitutional voting requirement for regular levies. The Constitution does provide a procedure for voter approval for tax rates that exceed the 1 percent limit. These taxes are called "excess" levies. The most common excess levies are maintenance and operation levies for school districts and bond retirement levies. The Constitution provides that excess levies must obtain a 60 percent majority vote plus meet a minimum voter turnout requirement.

Regular Property Taxes - Limit Factor. A district's regular property tax levy is limited by a statutory maximum growth rate in the amount of tax revenue that may be collected annually; this growth rate is known as the limit factor. For districts of 10,000 persons or more, the limit factor is equal to 100 percent plus the rate of inflation, although the governing body of the district (other than the state) may adopt a limit factor of up to 106 percent based on a finding of substantial need. For smaller districts, the limit factor is 106 percent.

Generally, the limit factor requires a reduction of property tax rates as necessary to limit the growth in the total amount of property tax revenue received to the maximum limit factor defined in statute. The limit factor does not apply to new value placed on tax rolls attributable to new construction, to improvements to existing property, to changes in state-assessed valuation, or to construction of certain wind turbines.

While the limit factor constrains regular property tax growth over time, a regular property tax district that chooses to levy an amount that is less than the highest lawful amount allowed under the full limit factor may retain the unused capacity for future use. This is known as "banked capacity." The amount of tax that a district levies in any one year may be more or less than the amount that would otherwise be expected by increasing the previous year's levy by the limit factor. The levy growth depends on whether the district is banking capacity for future use, tapping previously banked capacity, or neither. Many districts have maintained some amount of banked capacity in the past, but since the enactment of Initiative 747 (I-747; see below) the overall amount of banked capacity has diminished.

The limit factor for regular property taxes may be exceeded by voter approval; this process is known as a "lid lift." Lid lifts require approval by a majority of the voters in a taxing district, and allow the district to set its levy in an amount that exceeds the highest lawful amount that could be levied by the district governing body. However, the resulting tax rate must be less than the statutory rate limit.

Constitutional requirements with respect to legislation. The Constitution requires that, regarding legislation, bills contain only one subject, and that subject be contained in the title. The court has interpreted this requirement to mean that there must be rational unity between the subject matter within the measure and that the title adequately reflect the subject matter. The Constitution also requires that current law may not be amended by reference, but rather legislation amending current law must set forth in full the provisions being amended. The primary purpose of this requirement is to inform the public and the Legislature of the nature and effect of proposed changes and to avoid confusion from having disconnected sections scattered throughout the legal code.

History of the Limit Factor and Recent Litigation. The limit factor was formally established in the approval of Referendum 47 (R-47) in 1997. Prior to the passage of R-47, the maximum allowable growth rate for all regular property tax levies had been 106 percent. In approving R-47, state voters restricted taxing districts of 10,000 persons or more to a limit factor of 100 percent plus the rate of inflation, defined to be the change in the implicit price deflator index as determined by the U.S. Department of Commerce. However, districts of 10,000 persons or more other than the state could adopt a limit factor of 106 percent or less with a finding of substantial need by the district's governing body. The limit factor for districts of less than 10,000 persons remained at 106 percent.

In November 2000, state voters approved Initiative 722 (I-722), which among other things changed the maximum limit factor for all taxing districts from 106 percent to 102 percent and eliminated the authority to bank unused taxing capacity. That same month, however, the Thurston County Superior Court enjoined implementation of I-722. In February 2001, the Pierce County Superior Court invalidated the initiative under the title/subject rule. The Washington Supreme Court (Court) affirmed the superior court ruling in September 2001, thus returning law to that approved by the voters under R-47.

In January 2001, I-747 was filed. Under the initiative, the statutory changes under I-722 with respect to the 102 percent limit factor were modified, providing instead a 101 percent limit factor, unless approved otherwise by a public vote. I-747 also included nonsubstantive language that cross-referenced existing lid lift authority. I-747 did not include modification to the existing authority to bank unused property taxing capacity. In November 2001, two months after the Court invalidated I-722, voters enacted I-747.

In June 2006, the King County Superior Court invalidated I-747, ruling that the initiative violated constitutional requirements concerning amendment by reference. The ruling provided that the persons voting on I-747 were led incorrectly to believe that they were voting to amend the sections of law as amended by I-722 when, in fact, because I-722 had been struck down by the court before voters approved I-747, the voters were voting to amend the sections of law as amended by R-47. In November 2007, the Court affirmed the lower court's ruling, vacating the I-747 changes. Following the ruling, the Department of Revenue issued a memo to county assessors and treasurers providing an interpretation of the ruling. The interpretation provides that the Court's ruling means that regular property taxing districts have additional levying capacity equal to the difference in the hypothetical amount of banked capacity that would have

resulted had taxes been levied beginning in 2002 under the limit factor that was established by R-47 and the amount of banked capacity that was accumulated prior to the Court's ruling.

Summary of Bill:

Enacting the substantive provisions adopted by the voters under I-747, regular property tax growth levies at the district level are limited to no more than 1 percent growth annually.

The provisions are retroactive to and prospective from taxes levied for collection in 2002. The retroactivity extinguishes the additional levying capacity resulting from the November 2007 Court ruling, but lets stand any banked capacity accumulated prior to the court ruling and the authority to continue to bank future unused capacity.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect immediately.

Staff Summary of Public Testimony:

(In support) This bill allows taxing districts to move forward with certainty. The Legislature needs to recognize that the court must evaluate matters seriously with respect to the Constitution. So rulings may be occasionally unpopular and it is up to the Legislature to deal with addressing policy appropriately. We must face reality. In 2001, voters stated they wanted a 1 percent property tax cap. I understand that local governments have needs. I spent 25 years in local government and am keenly aware of this. However, we need to also think about seniors, people that are faced with mortgage issues and high gas prices.

Property tax increases are the number one concern of voters in my district. I believe the voters knew what they were doing when they voted for 747. This bill doesn't quite get at the issues the initiatives attempted to address. This is not the "be all end all" to fix property taxes. It provides a councilmanic limit. Districts may still go to their voters to exceed the limit. With other revenue sources and with lid lifts, districts are able to continue to provide adequate resources.

This bill is a direct response to the recent Washington Supreme Court decision. The Governor believes law has worked well and would like it to continue.

The bill extinguishes the additional capacity added by the court ruling. It does not do away with the authority to bank capacity under the 1 percent limit. This authority is important. It avoids the "use it or lose it" disincentive and makes governments fiscally responsible.

If the goal is to reinstate I-747 then this bill deals with that. There are two important elements. The bill restores the 1 percent limitation on the highest lawful levy over the

previous year amount. The other important element is to eliminate additional capacity gained as a result of the ruling.

Governor Gregoire and the democrats do not care about taxpayers. If they really cared they would pass a real 1 percent property tax limit. One that doesn't have a huge property tax increase built into it. The voters do not want a 1 percent cap with a \$108 million property tax increase buried inside of it. The voters repealed banking authority. The Legislature in this bill is only partially pandering to voters. Eliminate the banking authority now. The bill does not impose a real 1 percent cap. The Legislature is allowing \$108 million in buried higher property taxes to continue. Voters will understand if this if this not included.

(Opposed) We have watched narrowing of tax base over the years, substantially. Washington has a very regressive tax system. Those who have less to afford must pay more. We oppose the bill. Enactment would continue to put more burden on those who cannot afford to pay. Small homeowners may get some relief under the bill but not much. Large homeowners get much more benefit. Rather than enacting this, the Legislature should take time and consider other options such as a circuit breaker program. Please buy some time with a sunset clause. If that is impossible please vote no.

We are disappointed with hasty decision to call the special session. There is inequity in the system and the system is inadequate to provide realistic funding . Please treat the 1 percent cap as a stopgap measure. We need real reform. We need more thoughtful analysis. Please include a sunset clause. We agree people want meaningful tax reform. We don't believe the reinstatement of a 1 percent limit gets there. A circuit breaker program is a much better solution.

The Legislature is being railroaded by reelection concerns. We have the lowest property tax growth cap in the country. The cap does not allow governments to maintain services. The implementation of I-747 means services have been cut by \$1.6 billion. These are amounts that could have paid for improved teacher pay and classroom size reductions, for example. Figures from the Department of Revenue indicate the state citizens are not overtaxed, that our state ranks 27th nationally. Other figures show that the state is 38th nationally. A circuit breaker or homestead exemption program is a better alternative.

The 1 percent cap hurts local governments and has no logical basis. No corporation, for example, would operate knowingly if sales were limited to 1 percent growth. Retaining banked capacity authority is important. Banked capacity operates analogously to giving a child \$20 per day at Disneyland. If the child wants to spend the money each day, fine. But if on last day they want to buy a \$100 souvenir, then they should be able to save their money each day to do so. Please take time to look at property taxes thoughtfully.

While we applaud the leadership of the Governor and Legislature to step up to this issue, we oppose this bill. Property taxes fund essential services. Initiative 747 has made sure that essential services are not funded. We agree that the system needs reform. We are aware that the tax system is among the most regressive. We recognize the pressing need for overall tax

reform. However, we urge the Legislature to take time in regular session to consider all options.

The rush to re-adopt the provisions of I-747 means that services will be further eroded. A hasty decision is not in best interest of state citizens. We understand that interpreting will of the electorate is challenging. However, the voters have sustained increase of gas tax and recently reenacted an estate tax. Washington taxes are not high relative to those in other states. Middle and low income homeowners are being asked to pay more here. Instead of hurrying to reinstate provisions that make it difficult for municipal leadership to provide basic services, let's have a deliberative process during the regular session.

The Association of Washington Cities supports a regular property tax system with the Implicit Price Deflator (IPD) as a cap. Over the last 10 years, inflation as measured by IPD has averaged a bit over 2 percent. In 2006 property and sales taxes represented 47 percent of our revenues. Over the last 10 years, public safety costs have grown by 5 percent for cities and 6 percent for counties. Using the IPD as a cap is more reflective of the costs we face.

Property taxes represent 44 percent of King County's current expense revenue. The 1 percent limit in the bill will not allow the county to continue to provide adequate services over the long term.

The State Association of Counties supports the use of a limit based on IPD. Costs are affected by inflation, and our revenues should be allowed to keep pace. We believe that it is important that districts continue to have banked capacity authority. If the authority disappears, then they will tax at the maximum rate each year. Jefferson County is an example of the prudent use of this authority: the county has been banking unused capacity in recent years in anticipation of a future sewer project. We also agree that the Legislature must look at the whole system.

Our view is that reenacting the I-747 provisions helps preserve a regressive and inequitable tax system. The impact on local governments to fund services is significant. The cap of 1 percent is lower than the rate of inflation. A one-day effort is not the solution. The Legislature can do better.

(Comments) The Washington Policy Center has done research on whether I-747 has been effective. Indeed it has provided relief. We strongly disagree with the Department's characterization of the impact of this bill as 'revenue losses'. Most counties have received large increases in revenues in recent years; for example, Seattle's revenues rose 38 percent between 2001 and 2006. We have not found a single example where services have been cut back.

As written, the bill restores the I-747 policy. However, districts still have substantial banked capacity. The law allows districts to go back to voters to ask for local increases to cover basic services.

Persons Testifying: (In support) Representative Hurst, prime sponsor; Marty Brown, Office of the Governor; Cindi Holmstrom, Department of Revenue; Tim Eyman, Voters Want More Choices; and Dave Cook, Yakima County Assessor.

(With concerns) Bruce Reeves, Senior Citizens Lobby.

(Opposed) Barbara Bush, League of Women Voters of Washington; Bill Daley, Washington Community Action Network; Bud Sizemore, Washington State Council of Fire Fighters; Jim Justin, Association of Washington Cities; Julie Murray, Washington State Association of Counties; Steve Zemke, Taxpayers for Washington's Future; Christy Margell, Washington Tax Fairness Coalition; and Andrew Villeneuve, Northwest Progressive Institute.

(Comments) Paul Guppy, Washington Policy Center; and Lynn A. Harsh, Evergreen Freedom Foundation.

Persons Signed In To Testify But Not Testifying: None.