Why Significant, Lasting Property Tax Reform is So Difficult

Analyzing the League of Municipalities’ Property Tax Cut Plan

By David Rousseau
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Sales tax, lottery, income tax, casino gambling, SLERP, Whitman Property Tax Commission, 2006 Legislative Special Session, state aid to schools (QEA I, QEA 2, CEIFA, SFRA), state aid to municipalities, senior and veteran property tax exemptions, homestead rebates, property tax deduction, NJ SAVER, homestead property tax credits, senior property tax freeze, state assumption of county social service programs, state assumption of county court operating costs, spending caps, levy caps, consolidation incentives, binding arbitration reform, pension and health benefit reform.

These are all actions that New Jersey’s leaders have taken over the last 50 years to “relieve” the most regressive tax that New Jersey families pay: the property tax. Property taxes compete with the economy as the top issue affecting New Jersey citizens and have been one of the primary issues in state and local elections since the mid 1970s. Persistent promises of relief have accompanied steadily rising property tax burdens.

In 2012, New Jerseyans paid $26 billion in property taxes to support schools and county and local governments (up from $16 billion ten years earlier – an increase of 62 percent). In the current budget year, for comparison, the state is anticipating collecting slightly less – $24 billion – from the big three state taxes (income, sales and corporate).

Residential property taxes make up the lion’s share of property taxes paid: nearly 80 percent at about $20 billion (commercial and industrial properties make up most of the balance). The average New Jersey homeowner will likely pay about $8,000 in local property
Why Significant, Lasting Property Tax Reform is So Difficult

taxes in 2013 (the average was about $7,900 in 2012), or about 10 percent of the average household income of approximately $80,000. By contrast, the average family pays just 1.5 percent of its income, about $1,200, in state income taxes (assuming two children). For this average family, property taxes are 6.5 times higher than income taxes, a proportion that increases for families down the income scale. The less one earns, the bigger the chunk that goes out in property tax payments.

The League Enters the Debate

The New Jersey State League of Municipalities entered this decades-long debate in June with its Property Tax Reform Task Force proposal to remake the state’s property tax structure. The proposal calls for an immediate cut in residential property taxes on all primary homes, regardless of the owner’s income, of 25 percent. It would be increased to its full 35 percent cut over a four-year phase-in. Homeowners would see a credit on their property tax bills, with the state paying local governments the lost revenue. The credit would apply only to the first $20,000 in property taxes, producing a maximum tax reduction of $7,000 once fully the plan is fully phased in.

Under the League plan, all tenants regardless of income would receive an increase in the current tenant credit (from $50 to $200) claimed on their state income tax return. Approximately one-third of New Jersey households are renters, most at the lower income levels.

The property tax cut would be paid for by two sources: an increase in the income tax, which would raise $3.9 billion in the first year, and the end to existing direct property tax relief programs with their current costs of $1.16 billion.¹

The overall income tax increase of about 30 percent would mean that almost all New Jerseyans would pay more in income tax. The exceptions: Those making less than $20,000 – nearly 1.3

¹
million of the state’s 3.9 million filers – would see no increase, while the very small percentage with incomes or more than about $3.5 million – only 2,700 filers – would actually see a cut in their income tax.

![New Jersey’s Income Tax Would Become Less Progressive](chart)

**Source:** Source: NJPP analysis of New Jersey State League of Municipalities’ tax reform plan

**NEW JERSEY POLICY PERSPECTIVE**
Instead of simply increasing the tax rates for all income brackets by about 30 percent, the League proposal would fundamentally change the method for calculating New Jersey income tax.

In almost all discussions of federal and state income taxes, the rates given refer to marginal rates. The reason is that almost all federal and state income taxes are structured to impose lower tax rates on lower incomes and increase rates as incomes rise – thus, the “graduated” tax. In the 1950s, for example, when millionaires were famously taxed at 91 percent, no one paid $910,000 on their $1 million income.

New Jersey taxes all income within a tax bracket at the rate for that bracket, allowing for a smooth uptick as income increases and preventing spikes as a taxpayer’s overall income jumps to a higher tax bracket. The League proposes to tax all income at the rate of the taxpayer’s highest bracket, creating a more jagged system with the potential for much higher taxes as households move up from one bracket to another (moves that happen with income increases of as little as $2).

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<th>The Method for Calculating New Jersey Income Tax Would Be Fundamentally Changed</th>
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<tr>
<td><strong>Married Filer with $75,000 in Taxable Income:</strong></td>
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<td>First $20,000</td>
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<td>Final $5,000</td>
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<td><strong>TOTAL LIABILITY</strong></td>
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Total income tax liability excludes property tax deduction

Source: NJPP analysis of New Jersey State League of Municipalities’ tax reform plan

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<th>New Jersey’s Income Tax System Would Become More Jagged</th>
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<td><strong>As Little as $2 Difference in Income Could Create Large Tax Spikes</strong></td>
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<td><strong>Married Filers</strong></td>
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Source: NJPP analysis of New Jersey State League of Municipalities’ tax reform plan
The tax spike would create a situation where two neighbors who make roughly the same amount and live in homes of similar values and property taxes could end up with very different tax situations if one has a slightly higher income.

The only way to avoid dramatic tax increases in this kind of structure would be to add more brackets to smooth out the percentage increases as incomes rise so that the relief is more equitably distributed. More brackets, of course, compound the complexity of preparing tax returns.

In addition to this uncommon and fundamental shift in tax policy, the League would reduce the tax rates in the highest-income brackets: the current 5.525 percent rate would drop to 5 percent; 6.37 percent to 6 percent and the top 8.97 percent rate to 8.5 percent. Under these changes, households with incomes over about $3.5 million (only about 2,700 households out of 3.9 million) would actually get an income tax cut – on top of the likely maximum property tax credit of $7,000. Overall, New Jersey’s income tax would get slightly less progressive under the League plan.

The Context of Tax Reform

The League and its Task Force should be commended for making a significant and aggressive proposal to help shape the debate over tax reform in New Jersey. This proposal joins two other less-comprehensive proposals being discussed by legislators: The Christie/Sweeney plan, which would provide a phased-in 10 percent income tax credit on up to $10,000 in property taxes paid (funded entirely by diverting $1.6 billion in existing state revenues) and the Assembly Democratic plan, which would provide a 20 to 25 percent income tax credit on property taxes paid (funded by the same $1.6 billion and new revenue from increasing the income tax rate for income over $1 million and the existing funding for the homestead property tax credit).

The math makes it pretty clear: $20 billion of residential property taxes can be reduced a lot more with $5 billion than with $1.6 billion.

The reaction to the League’s proposal ranged from cool to freezing, with legislators largely ignoring it, the governor aggressively dismissing it while attacking the League’s executive director and the League itself retreating by saying the plan was intended to be merely the start of a conversation, not an absolute policy prescription.

The undertone at the forum held to present the proposal was pessimism that the governor and legislature would pass such a sweeping change and near-agreement that a constitutional convention would be needed to make such bold reforms to New Jersey’s tax structure.

The fact that the League proposal was dead on arrival confirms how hard it is to truly reform to the property tax structure, rather than provide limited relief within the existing framework.
Why Significant, Lasting Property Tax Reform is So Difficult

Why is ‘Reform’ So Hard?

The big reason property tax reform is difficult is the sheer scale of the taxes involved. With over $20 billion in residential property taxes paid in 2012, $5 billion is needed to provide a really noticeable 25 percent reduction. If the existing $1 billion in relief funding is folded into a new plan, that leaves $4 billion in new state revenue that lawmakers must raise, since the state budget is already stressed to just pay for current commitments and services.

To put $4 billion in perspective, it represents an increase of about 15 percent in the state’s major taxes. If only one of the major three taxes was targeted, $4 billion equals a 30 percent increase in the income tax; a 43 percent (3-cent) increase and/or substantial broadening of the sales tax; or a near-tripling of the corporate tax. Any of these options would easily top the overall $2.8 billion tax increase enacted by the Florio administration in 1990. In a climate where tax increases are taboo, few lawmakers would be willing to bet their political futures on a tax increase of that size – even if it was coupled with a significant lessening of the tax burden for many New Jerseyans.

The only way to avoid raising state taxes is to divert funds from current spending. Given a state budget of $32 billion, $4 billion would be a noticeable hit, particularly since so much of the budget is untouchable. The $9 billion in state aid to school districts, for example, cannot be reduced if the goal is to relieve local property taxpayers of at least some of their school taxes. Nor can the $2 billion or so in pension payments be diverted without endangering the state’s already low credit rating. The $1 billion to operate prisons cannot be reduced, at least not quickly. The state is expanding Medicaid, so shrinking its $5 billion or so is off the table. With just four examples, half the budget is beyond reach. Many other crucial state obligations could be cited, but raising state taxes looks like the only way out.

Impact: Who Wins and Who Loses

Proposals to restructure a tax system invariably include taxpayers that benefit (winners) and those that do not (losers). If there were no winners and losers, there would be no reason to make such a proposal. Examining the winners and losers determines if a plan is broadly fair and reasonable, but it also provides a lens through which legislators and individuals will view a proposal (the impact on the people that they represent and the impact on their own wallets, respectively).

The League’s proposal is difficult to analyze because there is very limited data on how much New Jerseyans at various income levels pay in both income and property taxes. In addition, the League’s smart decision to fold the $1.1 billion from the various existing property tax relief programs requires the current benefit levels to be factored into the new program – and the amount received under these programs differ widely depending on income level and town of residence.
But based on the information we do have—on the impact of the proposed income tax increase—we can determine that some groups will be winners. We can also determine what level of property tax paid represents a “break-even” point for different groups. In short, at what point do reduced property taxes equal the sum of increased income tax payments and the loss of credits from current property tax relief programs? A homeowner with property taxes paid above this break-even point will see a net tax increase. A homeowner with property tax below this break-even point “wins” with lower total tax payments.

**Homeowners (single and joint filers) and tenants with taxable income less than $20,000:** These households would not see any increase in income tax; if they own a home they would receive the full property tax credit.

For non-senior homeowners in this tax bracket (of which there are very few), the new property tax credit would be offset by the loss of the credit currently received under the Homestead Credit program (the average is $400) and the property tax deduction (range of $50 to $90). Homeowners with property taxes of more than $1,300 to $1,400 would benefit under the League proposal (try to find any New Jersey property tax bill that is $1,300 or less.) Their net benefit would be 35 percent of the difference between their property tax paid and the break-even point. For example, with a property tax bill of $2,500, the net benefit would be approximately $400.

For senior homeowners in this tax bracket, the new property tax credit would be offset by the loss of the credit currently received under the Homestead Credit program (the average is $520), the property tax deduction ($50 to $100) and the more than $1,300 on average they receive from the Senior Property Tax Freeze. Any senior homeowner with property taxes of more than $5,300 to $5,500 would benefit under the League proposal. The amount of benefit from the senior freeze can vary significantly among this income group: Newly eligible seniors receive an average benefit of around $200 and long-time recipients receive much more than the $1,300 average.

However, the break-even point would have to be higher to offset the loss of the current constitutional $250 credit for the nearly 60,000 seniors and disabled persons with income under $10,000 and the $250 credit for veterans, the break-even point rises to $6,600. An additional approximately $700 in property taxes would be needed to offset the loss of the $250 senior and disabled credit and another $700 in property taxes would be needed to offset the loss of the veterans credit.

Overall, there are likely more senior homeowners than non-seniors in this income bracket, since taxable income is only a portion of their total income (Social Security and up to $20,000 in pension income is exempt from New Jersey income tax).

All tenants at this level would receive a net benefit of $150, as the current $50 “tenant rebate” is increased to $200.
Why Significant, Lasting Property Tax Reform is So Difficult

Married homeowners and tenants with taxable income between $20,000 and $50,000 and single filers with taxable income between $20,000 and $35,000: These households would see a $70 income tax increase and, if they own a home, would receive the new property tax credit.

As with non-senior homeowners with income under $20,000 the net benefit from the new credit would be offset by the loss of the $400 Homestead Benefit and the loss of the property tax deduction ($50 to $175). In addition, the break-even point for this group would be slightly higher than the lower income bracket since it also needs to account for the $70 increase in income taxes and the slightly higher current benefit from the property tax deduction. An additional $200 in property taxes would be required to offset the $70 income tax increase.

Seniors with this income level would also have the same issues as those with taxable income under $20,000 and – as with non-seniors – the new benefits also need to offset the added $70 in state income tax and the slightly higher current benefit from the property tax deduction.

All tenants at this level would receive a net benefit of $80, as the current $50 “tenant rebate” is increased to $200 and the income tax is increased by $70.

Married tenants with incomes over $50,000 and single tenants with income over $35,000: These households would not benefit from the proposal since the income tax increase of at least $420 outweighs the $150 increase in tenant rebates. As a tenant’s income increases, the income tax increase becomes greater and would further outweigh the increased tenant rebate. However, once income reaches around $3 million, income tax liability actually decreases for these taxpayers and they would receive a decrease in income taxes and, if they are a tenant, they would receive the extra $150 from the increase in the tenant rebate (it is highly unlikely there are many, if any tenants at this income level, and if there are, if the $150 savings would be noticed).

Married homeowners with income over $50,000 and under around $3.5 million and single homeowners with incomes over $35,000 and under $3.5 million: These households would see a mixed result, with some benefitting and others not. With limited data on the relationship between income and property taxes, it is not possible to estimate the exact benefit. The following charts reflect the amount of property taxes that a homeowner would need to have to offset the income tax increase combined with the loss of the property tax deduction. For each $500 in property taxes paid above the break-even point, the homeowner would benefit by an additional $175.

For non-senior homeowners making less than $75,000, the loss of the current $400 they receive from the Homestead Benefit credit would also need to be offset, raising the break-even point by $1,150.

For senior citizens with taxable incomes under $150,000, the loss of the current $500 from the Homestead Benefit credit would need to be offset, raising the break-even point by $1,400. In addition, for those seniors with real income of under $70,000 (taxable income would vary based on the Social Security and pension income they receive), the average $1,300 that they currently
receive from the senior freeze will need to be offset and will significantly increase the break-even point – to the point where they may end up paying more in combined income and property taxes. Finally, if the homeowner is a veteran the loss of the current $250 veteran’s credit would also need to be offset – requiring even more in property taxes to achieve the break-even point.

Married and single homeowners with incomes over around $3.5 million: These households would receive an income tax cut as well as a property tax credit of up to $7,000. As mentioned above, tenants at this income level would also receive an income tax cut but would only be eligible for the increase of $150 in the tenant rebate.

Finally, it should be noted that any net savings any homeowner receives would likely be offset by some increase in federal taxes since the taxpayer would have less in property and income taxes to deduct on their federal tax return. Conversely, those homeowners and tenants that have a net increase in property taxes and income taxes would have a portion of the increase offset by lower federal taxes.

Where Do We Go From Here?

As the debate on how to provide relief to property taxpayers and reform New Jersey’s tax system continues, it should be guided by goals. So what are the goals?

If the goal is to provide real reform, it should use a “property tax circuit breaker” to provide relief to those who are most in need – homeowners with property tax burdens that exceed a set percentage of their income. While some past property tax relief programs have attempted to do this, they have not been pure – they always provided minimum benefits to those that may not have needed the relief, or provided caps that limited the amount of relief.

A true circuit breaker should meet the following criteria:

- Setting a level of property taxes as a percentage of income to benefit taxpayers that are most overburdened; this could be as low as 5 percent or as high as the current average, 10 percent
- Using real income, not taxable income, to treat non-seniors and seniors the same
Why Significant, Lasting Property Tax Reform is So Difficult

- Realizing that if a homeowner’s property tax falls below the threshold they would receive no benefit since they do not meet the “overburdened” definition
- Setting a maximum income level above which taxpayers would be ineligible (the lower the percentage of income that triggers the circuit breaker, the less likely that high incomes would be eligible)
- Using the income tax to pay for the tax credits generated since the increased payments can be deducted from federal income taxes (using other taxes to decrease property taxes reduces deductibles on federal tax returns)
- Folding all current property tax relief programs into the new program
- Delivering the benefit through a direct reduction in property tax bills, not an income tax credit, so homeowners do not have to wait as long as a year to receive the benefit
- Agreement from mortgage companies that the escrow accounts – and, thus, the monthly payments for homeowners with mortgages – reflect the credit
- Constitutionally dedicating any new revenues to be used exclusively for this program.

It is clear that this issue will not likely be addressed in the near future since the current administration has stated its absolute rejection of any tax increases. A constitutional convention may be just as difficult since some legislators may want to address the spending side of the ledger and not limit it to property tax relief.

Time is not on side of burdened property taxpayers. Moving forward without major reform, the cost of relief will increase (as property taxes continue to rise, more revenue will be needed to provide a reasonable benefit), making the prospect of enacting reform even more remote.
Endnotes

1 The existing relief programs, and their annual costs, are: Homestead Benefit program ($400 million),
2 Eliminating these constitutional dedications would require amending the constitution.