

Department of Legislative Services
 Maryland General Assembly
 2004 Session

FISCAL AND POLICY NOTE

House Bill 1168 (Delegate Gordon, *et al.*)
 Ways and Means

Land Value and Incentive Taxation Act

This bill significantly alters the land valuation and assessment process in Maryland.

The bill takes effect July 1, 2004.

Fiscal Summary

State Effect: Special fund revenues could be affected depending on the tax rates imposed by the Board of Public Works (BPW) based on land assessments. It is assumed that the rate set for land would be sufficient to cover debt service and would not result in a significant increase or decrease in Annuity Bond Fund revenue. General fund expenditures could increase by approximately \$1.8 million in FY 2005. Future year expenditures reflect annualization and inflation.

(\$ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
SF Revenue			--	--	--
GF Expenditure	1.8	2.1	2.3	2.4	2.6
Net Effect	(\$1.8)	(\$2.1)	(\$2.3)	(\$2.4)	(\$2.6)

Note :() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local government revenues could be affected depending on whether the tax rate for land is increased or decreased.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill: (1) provides that all improvements to land are exempt from the State property tax effective on the repayment of all State bonds that are outstanding or authorized on or before July 30, 2004 and to which a State property tax on assessed property is pledged; (2) requires BPW to set a State property rate of \$0 per \$100 of assessment for improvements to land; (3) requires local governments to set property tax rates for three classes of property: land, improvements to land, and personal property; (4) provides specifications for setting local property tax rates; (5) creates two new classes of real property: land that is used as operating real property of a railroad and land that is used as operating real property of a public utility; (6) provides that improvements to land are divided into three subclasses: improvements to land that is used as operating property of a railroad, improvements to land that is used as operating property of a public utility, and all other improvements to land; and (7) repeals obsolete provisions of property tax law.

Local tax rates under the bill must be set as follows: (1) a tax rate for improvement to land, which may be equal to zero and must be lower than the rate set for land; (2) a tax rate for operating utility improvements to land, which must be 2.5 times the rate for improvements to land. If the improvement to land rate is equal to zero, the operating utility improvements to land rate must be equal to zero also; (3) a personal property tax rate for operating personal property of a public utility, which must be equal to 2.5 times the rate for improvements to land; if the improvements to land rate is equal to zero, the operating utility personal property rate must also equal zero; (4) a personal property tax rate, which may equal zero and must be lower than the rate for land; (5) a land tax rate, which must be higher than the rate for either improvements to land or personal property; and (6) a tax rate for land of an operating public utility, which must be 2.5 times the rate for land.

Current Law: The State property tax rate is \$0.132 per \$100 of assessment. State property tax revenues are deposited into the Annuity Bond Fund to pay debt service on general obligation bonds. Personal property is exempt from State taxation.

Currently, most local jurisdictions have two tax rates: a real property tax rate and a personal property tax rate. The real property tax rate is applied to real property and the operating real property of railroads. The personal property tax rate is applied to business personal property, the operating personal property of railroads, and the operating real and personal property of public utilities.

Background: The State Department of Assessments and Taxation (SDAT) is required to place a market assessment on all real property, business personal property, and all real and personal property of operating railroads and utilities. For all nonoperating real

property, SDAT is required to place a value on the land and a value on any existing improvements. For all jurisdictions in the State, except Worcester County, more than half of the assessable base is attributed to improvements to land.

Currently, two towns in Prince George's County set a separate, higher rate for commercial real property. These towns, Colmar Manor and North Brentwood, would no longer be able to set a separate tax rate for commercial property under the bill.

The amount of property tax owed is determined by the assessment and the property tax rate. Assessments are based on the fair market value of the property and are issued by SDAT. Property tax rates are set by each unit of government – the State, counties, and municipalities.

An assessment is based on an appraisal of the fair market value of the property. An appraisal is an estimate of value. Assessors are the appraisers who estimate the value of the property for tax purposes. Assessors are trained to use standard appraisal approaches and techniques to determine the appraisal estimate. There are three accepted approaches to market value: (1) the sales approach; (2) the cost approach; and (3) the income approach. While differing in the method of calculation, each approach is designed to indicate the property's fair market value.

Land Taxation

Land taxation is a philosophy of property taxation where more value is placed on the land itself rather than on improvements (buildings) made to the land. The goal behind land taxation is to encourage land to be used at its highest and best use.

Land taxation is done in Australia, New Zealand, South Africa, Denmark, and Russia and is based on the theories of economist Henry George. The two-rate tax structure (one rate for the land and one rate for improvements) has been adopted by 20 cities or towns nationwide. Nineteen of these are located in Pennsylvania. The other is the City of Amsterdam, located in New York State. In Pennsylvania, Pittsburgh adopted a two-tier tax system in 1976 but discontinued that practice in 2001. Major flaws in the assessment process in Pittsburgh and a series of lawsuits arose from the problems with the system.

State Revenues: The bill could result in an increase or decrease in State special fund revenue depending on the tax rates imposed by BPW based on land assessments. It is assumed that the rate set for land would at least be sufficient to cover debt service and therefore would not result in a significant increase or decrease in Annuity Bond Fund revenue.

State Expenditures: This bill could cause a significant increase in the number of assessment appeals. Currently, approximately 700,000 properties are reassessed annually. Of those, about 4% appeal each year. Because the total market value would no longer be the basis of the taxes paid under the bill, many more property owners are expected to appeal their assessments in order to lower the assessment on the land while increasing the assessment on the improvements. SDAT will require additional real property assessors to handle the anticipated increase in the number of assessment appeals each year.

Utility and railroad property is valued differently than other real property. First, a value for the entire utility is determined, and then the value is apportioned so that a value for the utility in Maryland is made. Then, a value is set for each county and municipality in which the utility or railroad operates. These values are then certified as either real or personal property. The real property component is not divided into land and improvements as required under the bill. This results in a complicated calculation and will require the addition of new utility assessors.

As a result, general fund expenditures could increase by an estimated \$1.8 million in fiscal 2005, which takes into account a 90-day start-up delay. This estimate reflects the cost of hiring two administrative officers and 50 real property assessors to conduct property assessments, as discussed above. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. Future year expenditures reflect: (1) full salaries with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Local Revenues: The effect on local government revenues would depend on what the tax rates on land and the various subclasses are set at. Depending on the various rates, revenues could increase, decrease, or remain the same.

Local Expenditures: The bill significantly alters the basis for the assessable base for all local jurisdictions. The setting of tax rates by local jurisdictions will be more complicated. As a result, local governments could incur significant expenditure increases to comply with the requirements of the bill. Cecil and Harford (\$600,000) counties indicate a significant expenditure increase in order to comply with the requirements of the bill.

Small Business Effect: Depending on whether tax rates for land are increased or decreased, small businesses could either pay additional property taxes or reduced property taxes.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): State Department of Assessments and Taxation, Cecil County, Montgomery County, Prince George's County, Harford County, St. Mary's County, Board of Public Works, Baltimore City, Carroll County, Department of Legislative Services

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