Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

House Bill 842 (Delegate Gordon, *et al.*)
Ways and Means

Land Value Taxation - State Property Tax

This bill exempts improvements to land from the State property tax, with specified exceptions, including improvements that are part of operating real property of a public utility. Under the bill, the first $15,000 of value of agricultural land and the first $40,000 of value of land used as a principal place of residence is exempt from the State property tax. The bill establishes separate classes for property tax purposes for land and improvements to land. The bill establishes a new subclass of land for land that is used a principal place of residence. The bill repeals obsolete provisions of law related to the taxation of intangible personal property for State property tax purposes.

The bill takes effect October 1, 2005 and applies to taxable years beginning after June 30, 2006.

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 $2.1 million in FY 2006. Future year expenditures reflect annualization and inflation.

($ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Revenues	$0	$0	$0	$0	$0
GF Expenditure	2.1	2.5	2.6	2.8	3.0
Net Effect	($2.1)	($2.5)	($2.6)	($2.8)	($3.0)

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

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: There is a well-defined statutory relationship between the State and local governments in the administration of the property tax system in Maryland. While property tax revenues are a relatively minor revenue source to the State, the State has assumed responsibility for the valuation and assessment of property. Local governments, on the other hand, levy and collect property taxes. The State takeover of the valuation and assessment function was implemented to provide uniform and equitable assessments of property throughout the State, in compliance with the "uniformity clause" of the Maryland State Constitution. Article 15 of the Declaration of Rights provides that the State shall "by uniform rules, provide for the separate assessment, classification and sub-classification of land, improvements on land, and personal property . . . and all taxes . . . shall be uniform within each class or sub-class . . ."

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.

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 used, to some degree in several countries throughout the world, including, Australia, New Zealand, South Africa, Denmark, and some former Soviet republics. Land taxation 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 several cities or towns nationwide, including 19 jurisdictions in Pennsylvania, 1 in New York State, and 1 in Hawaii. Legislation has recently been introduced in Connecticut and Minnesota authorizing a two-tiered rate structure.

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 be at least sufficient to cover debt service and therefore would not result in a significant increase or decreases in Annuity Bond Fund revenue.

Exhibit 1 shows what the total State property tax rate would have to be set at so that revenues are sufficient to cover debt service on State bonds.

Exhibit 1
Estimated Total State Tax Rate to Cover Debt Service on State Bonds

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Base Land Tax	$214,802,776,821	$244,875,165,576	$279,157,688,757	$301,490,303,857	$316,564,819,050
Residential Exemption	56,102,240,000	56,102,240,000	56,102,240,000	56,102,240,000	56,102,240,000
Ag Land Exemption	834,450,000	834,450,000	834,450,000	834,450,000	834,450,000
Total Base	157,866,086,821	187,938,475,576	222,220,998,757	244,553,613,857	259,628,129,050
Annuity Bond Fund		$643,107,160	$682,345,909	$731,220,921	$765,917,961
Tax Rate		**0.342**	**0.307**	**0.299**	**0.295**

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 $2.1 million in fiscal 2006, which takes into account a 90-day start-up delay. This estimate reflects the cost of hiring 50 real property assessors and 1 utility assessor to conduct property assessments, as discussed above. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses

Salaries and Fringe Benefits	$1,750,704
Additional Equipment	240,500
Operating Expenses	63,289
Total FY 2006 State Expenditures	**$2,054,493**

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 Fiscal Effect: 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.

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.

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, Department of Legislative Services

Fiscal Note History: First Reader - March 21, 2005
mam/hlb

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