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The Fallacy of a Dual Tax Rate

Presentation to Wellesley Board of Selectmen

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On behalf of

Wellesley Chamber of Commerce

September 26, 2011

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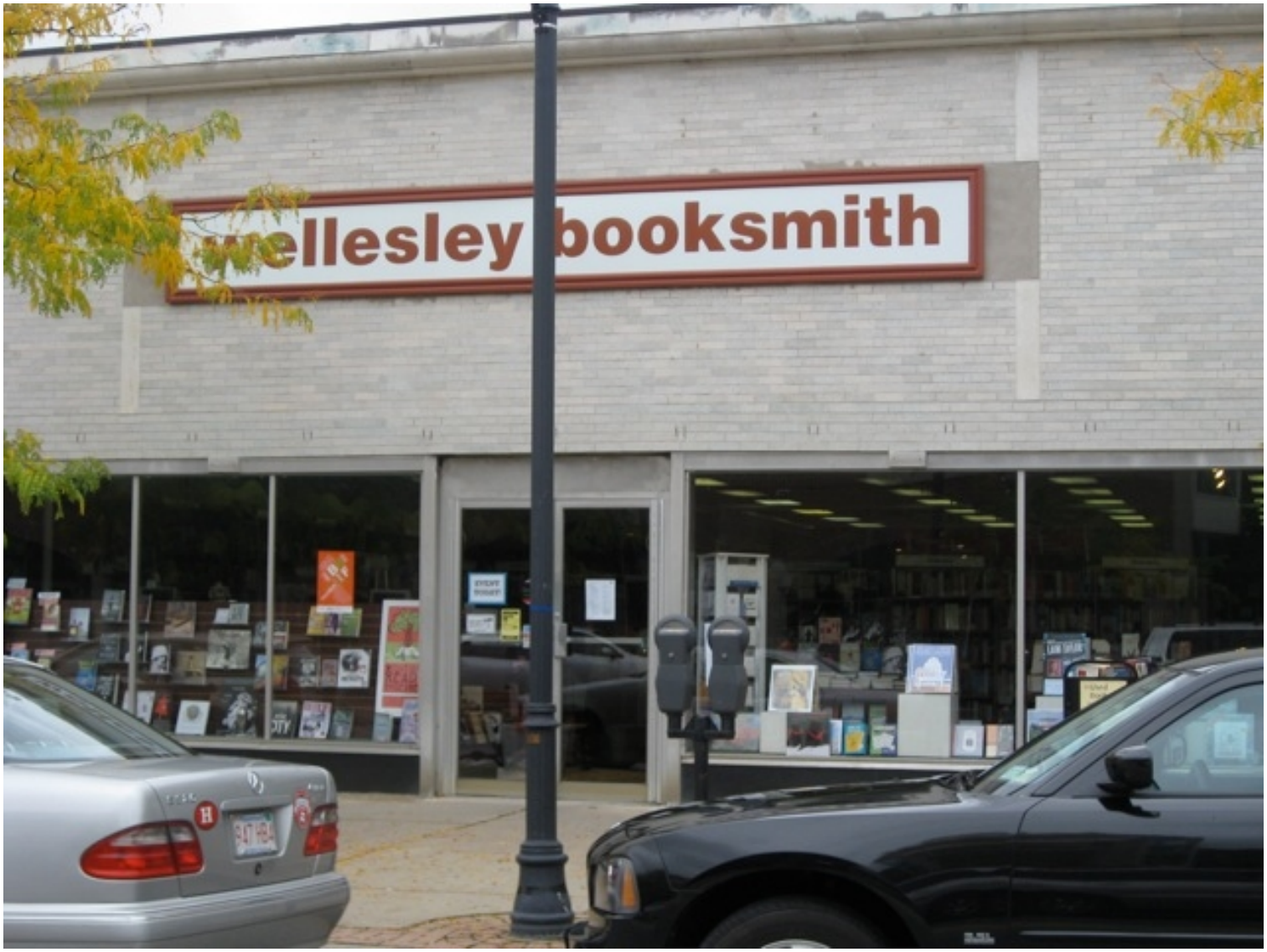
Roche Bros.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Summary

- Dual tax rate does not increase tax revenue
- Dual tax rate is inequitable and unfair to the business community
- No logical or compelling reason to enact a major policy change
- Significant adverse impacts on business community for relatively small benefit to residential taxpayer
  - Unintended consequences
- The business sector consumes less in services than it pays in taxes

Background: Tax Setting Process

- Selectmen set the tax rate annually
  - Option to shift the burden
  - Policy issue not a financial issue
- Tax rate based on the town's levy and assessed value of all property in town
  - Levy divided by assessed value
  - Year to year changes result from changes in assessed values and spending

Background: Genesis of Dual Tax Rate

- Prior to enactment of Prop 2½ municipalities taxed at uniform rate but applied that rate to differing percentages of market value ("fractional assessments")
  - System of fractional assessments deemed unconstitutional by state Supreme Judicial Court
  - Required full and fair cash valuation of all properties
- Classification arose because many communities had been "over-valuing" commercial properties
  - Without classification some communities would have seen large increase in residential tax bills
  - Legislature allowed cities and towns in Massachusetts to use different tax rates for different classes of property

Background: Impact of Dual Tax Rate

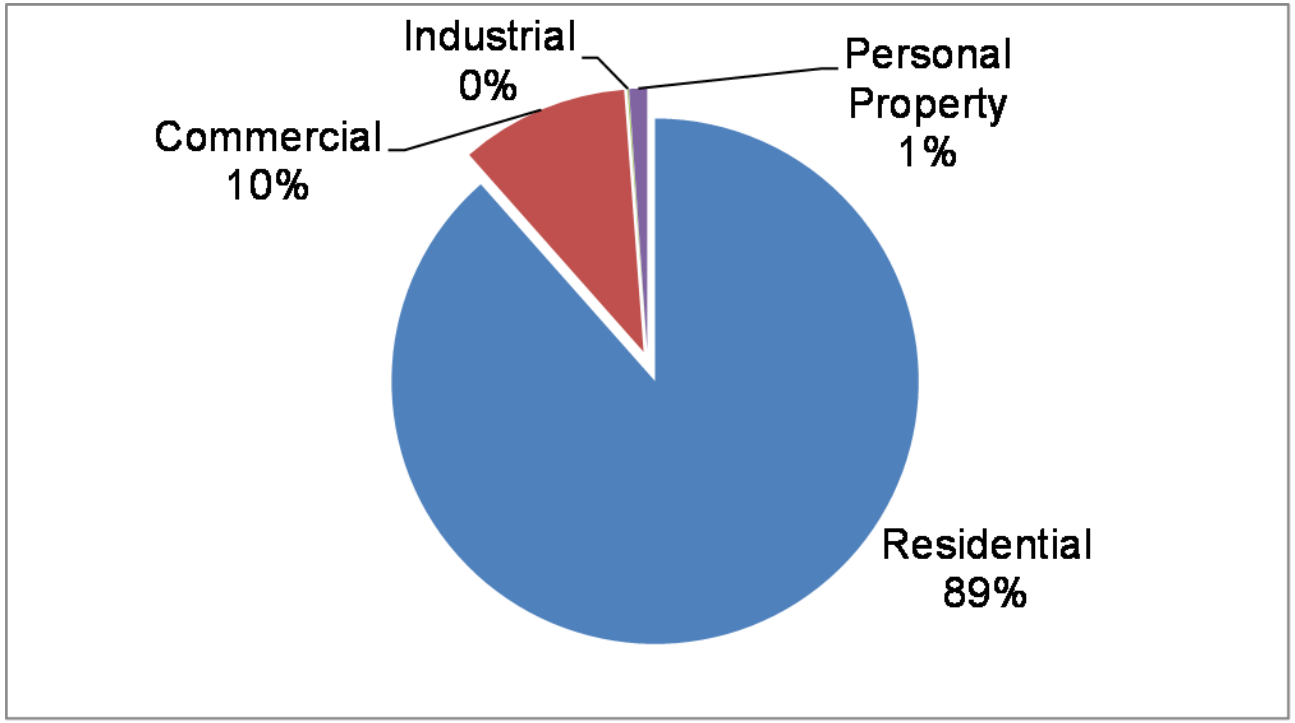
- Classification shifts the levy from one class to another
- It does NOT increase the amount of tax revenue
  - Levy limited by Prop 2½
- Proposal to go to a dual tax rate would increase average commercial property tax bill by 50%
  - Even a smaller shift would cause a decline in values and create uncertainty about the future
- Average residential tax bill would fall by only 6.6% based on FY2011 Assessors' data

Equity/Fairness Issues

- Shifting the tax burden to the business sector is inequitable and unfair
  - Equity and fairness suggest that everyone should pay the same rate
  - Taxes paid should reflect fair market value of property
- Given the high proportion of total assessed value accounted for by residential class, impact of a shift is great on commercial taxpayer with relatively small benefit to residential taxpayer

Equity/Fairness Issues

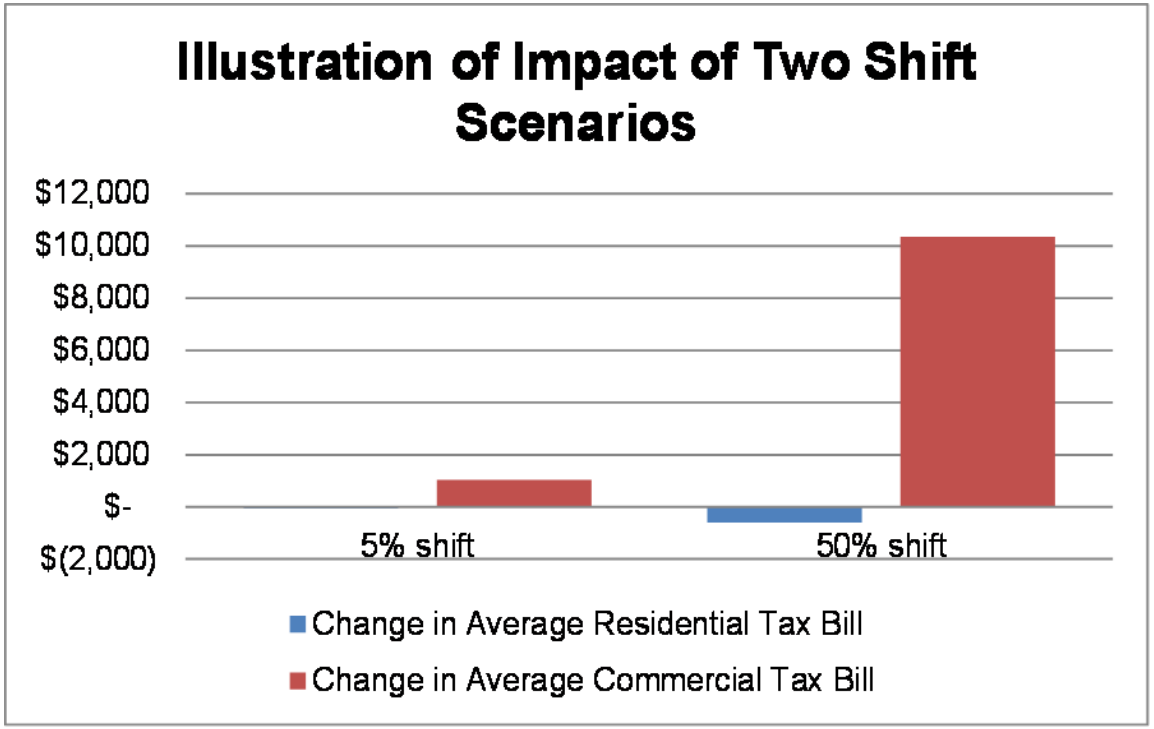
Wellesley's property base is overwhelmingly residential:



Data from FY2011 Assessors' presentation to Board of Selectmen

Equity/Fairness Issues

- Every $1 decline in average residential tax bill leads to a $17.45 increase in average commercial property tax bill



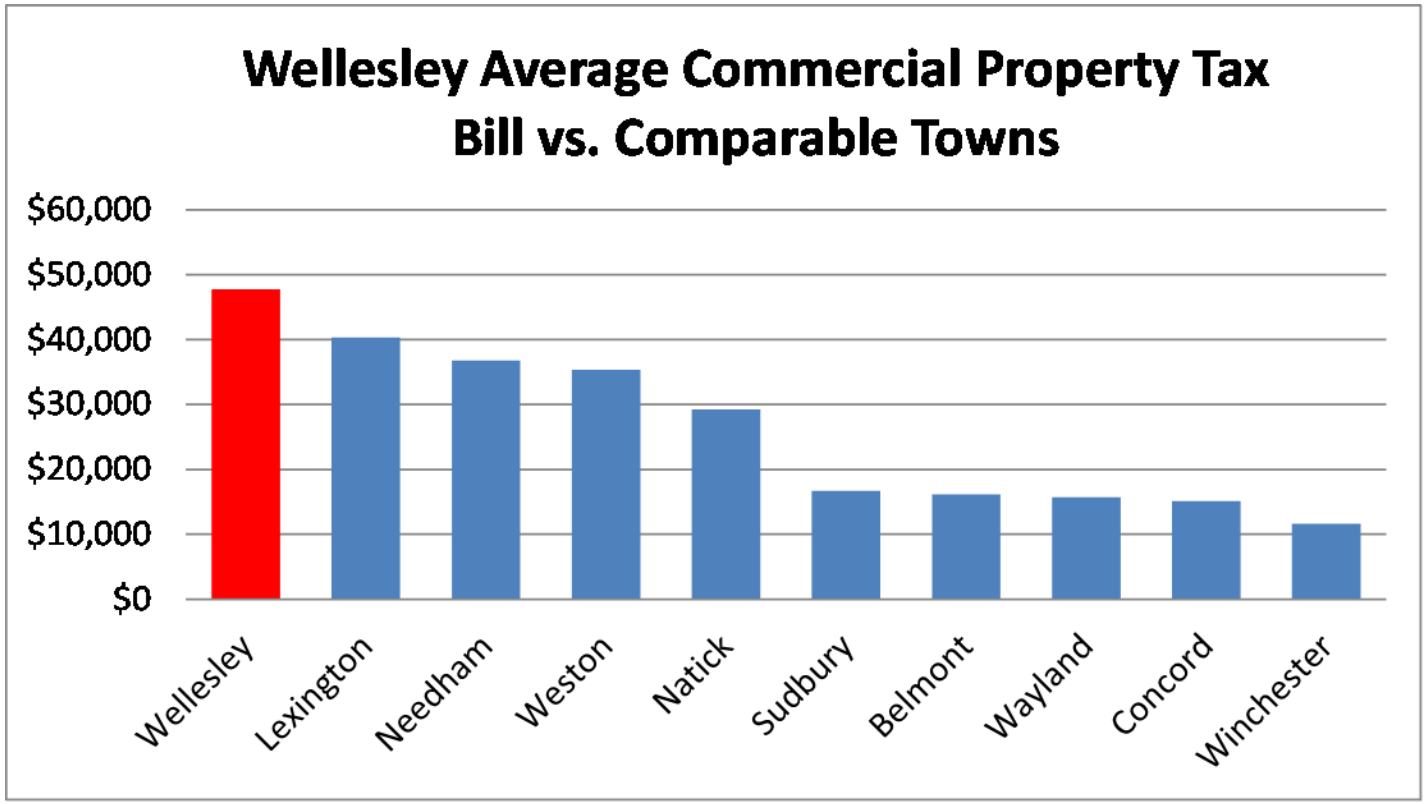
Data from FY2011 Assessors' presentation to Board of Selectmen

Equity/Fairness Issues

- Shift to a dual tax rate will severely impact businesses in town, especially smaller property owners and tenants
  - Since many leases pass on tax increases to tenants, some local businesses may not be able to absorb this increase
  - Potentially relocate to other towns
  - Creates an uncertain operating environment for many

Equity/Fairness Issues

- Wellesley commercial property owners already pay an extremely high tax *bill*



Source: Department of Revenue, Municipal Database

Equity/Fairness Issues

- In recent years Wellesley's business sector has contributed relatively more to the property tax base
- CIP new growth added $109 million to assessed value over last five years
  - Represents 14% of total new growth value
- Median value for commercial property over same period has held steady while residential properties dropped by almost 5%
- Business sector already seen a larger increase in taxes than residential sector
- Business is also a significant contributor to the community in other ways

Wellesley is not the typical dual tax rate town

- Only 107 of 351 communities in Massachusetts have a dual tax rate
- Average CIP portion of total assessed value in these communities is 22%
  - Approximately double Wellesley's share
- The average CIP portion of total assessed value for uniform rate cities and towns is 11.5%
  - The same as Wellesley

Wellesley is not the typical dual tax rate town

- Cities and towns have a dual tax rate where commercial class is significant portion of total value
  - Shifting the tax burden in communities where commercial sector is much larger yields a greater benefit at a lower cost to the business segment

    "Even from the point of view of a self-interested voter, multiple tax rates are not a useful option if there is very little nonresidential property to shift the tax burden"

    Katherine Bradley, "Shifting Property Tax Burdens in Massachusetts" *New England Economic Review*, September/October 1988

Wellesley is not the typical dual tax rate town

- One set of communities with split tax rates is characterized by either or both:
  - A high percentage of CIP value (green)
  - Historical overvaluation of CIP properties (white)
    - Most went to split tax rate immediately after achieving full market value (1981-1986)

	CIP Ratio	1980 Overvalue CIP?	Split Rate Today ?
Barnstable	12%	N	N
Boston	35%	Y	Y
Brookline	9%	Y	Y
Cambridge	39%	Y	Y
Falmouth	8%	N	N
Framingham	25%	Y	Y
Lexington	13%	Y	Y
Nantucket	8%	Y	Y
Needham	13%	Y	Y
Newton	10%	Y	Y
Plymouth	23%	N	N
Quincy	17%	N	Y
Somerville	15%	Y	Y
Waltham	33%	Y	Y
Wellesley	11%	N	N
Worcester	22%	Y	Y

Source: Department of Revenue, Municipal Database; Bradley, op cit.

Wellesley is not the typical dual tax rate town

- Second group of communities follows one of two patterns:
  - Split rate due to overvaluation in 1980 (white)
  - Uniform rate, not overvaluing in 1980, and relatively low effective tax rate (blue)

	CIP Ratio	1980 Overvalue CIP?	Split Rate Today ?
Belmont	6%	Y	N
Brookline	9%	Y	Y
Concord	9%	N	N
Lexington	13%	Y	Y
Natick	8%	Y	N
Needham	13%	Y	Y
Newton	10%	Y	Y
Sudbury	7%	Y	Y
Wayland	5%	N	N
Wellesley	11%	N	N
Weston	5%	N	N
Westwood	13%	Y	Y
Winchester	6%	Y	*
* Winchester taxes residents at a *higher* rate than CIP			

Source: Department of Revenue, Municipal Database; Bradley, op cit.

Wellesley is not the typical dual tax rate town

- Wellesley has one of lowest effective tax rates
- 6 of 9 communities below state average have uniform tax rate
- 3 of 4 above state average have dual rate

	Effective Tax Rate	Split Rate Today ?
Brookline	1.06%	Y
Weston	1.14%	N
Wellesley	1.14%	N
Newton	1.19%	Y
Winchester	1.21%	*
Needham	1.23%	Y
Natick	1.26%	N
Concord	1.32%	N
Belmont	1.32%	N
Westwood	1.54%	Y
Lexington	1.60%	Y
Sudbury	1.74%	Y
Wayland	1.94%	N
State Average	1.39%	70% N; 30%Y

* Winchester taxes residents at a *higher* rate than CIP

Source: Department of Revenue, Municipal Database

Wellesley is not the typical dual tax rate town

- These communities are “more” comparable in terms of intermunicipal competition
  - Most have relatively low CIP value shares
- Those with split tax rate reflect legacy from the past, not a new policy decision
- Wellesley fits the mold of those with a uniform tax rate

Unintended Consequences

- There are likely to be unintended consequences of a 50% increase in commercial tax bills or even a smaller increase
  - Dual tax rate does not increase the levy
    - Nor does the small commercial exemption
- Given the method used to value commercial properties, values are likely to ***decline*** in future with a dual tax rate
  - Income capitalization approach is used to assess commercial property

Unintended Consequences

- If property owners cannot pass on the tax increase then their profits will be affected thereby reducing assessed values in the future causing “reverse shift” of burden back to residential taxpayers
- If property owners can pass on the impact of the increase in property taxes, the burden is felt by the small business owner
  - May induce tenants to leave
- If tenants leave, property owners may look to alternative uses for their property

Unintended Consequences

- Towns that have “experimented” with dual tax rate generally find it causes values to decline relative to uniform rates
  - Lincoln
- Towns that have eliminated a dual rate have experienced greater or average levels of CIP growth
  - Concord

Commercial Taxpayers Consume Less in Services Than They Pay In Taxes

- Properly analyzed, businesses support the local tax base with little draw on services relative to residential taxpayers
- Numerous studies have shown that commercial taxpayers consume *less* in municipal services than what they pay in property taxes
  - These studies show that for every dollar paid in taxes, the business sector consumes significantly less in services

Commercial Taxpayers Consume Less in Services Than They Pay In Taxes

- Our *preliminary* analysis of who pays for community services in Wellesley is consistent with prior studies
- The analysis suggests that for every $1 paid in taxes the business sector consumes about $0.44 in services
  - Residents consume about $1.07 in services for every $1 they pay in taxes

	Total	Residential	CIP
Revenues	$123,140,780	$109,902,074	$13,238,706
Expenses	$123,140,780	$117,337,949	$5,802,831
Ratio	1.00:1.00	1.07:1.00	0.44:1.00

Conclusion

- Dual tax rate does not increase tax revenue
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- The business sector consumes less in services than it pays in taxes