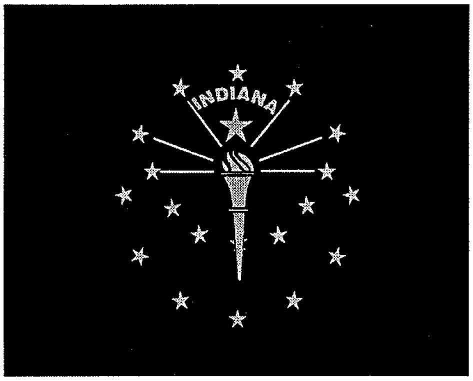


# IACIR White Paper #2

## Indiana's Market Value Assessment Study

by

Larry DeBoer
Professor
Department of Agricultural Economics
Purdue University

Center for Urban Policy and the Environment
Indiana University School of Public and Environmental Affairs

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## PREFACE

The **Indiana Advisory Commission on Intergovernmental Relations** was established by the General Assembly in 1995 to provide a forum to work through the problems that naturally will arise as greater demands are made on state and local governments. The Indiana legislation was based upon federal and other states' enabling statutes.

The Indiana Advisory Commission on Intergovernmental Relations is launching an effort to improve intergovernmental decision making and partnerships by serving as a forum for discussion and resolution of intergovernmental problems and concerns. The mission of the Indiana Advisory Commission on Intergovernmental Relations is to create affective communication, cooperation, and partnerships between the federal, state, and local units of government in order to improve the delivery of services to the citizens of Indiana through:

- A better understanding of the process of government and the intended and unintended outcomes of policy decisions;
- Improved communication between all levels of government and citizens;
- The promotion of long-term planning between all levels of government; and
- Applied research on policy areas in order to better understand the impacts of mandates and policy changes.

Section 12 of the statute establishing the Indiana Advisory Commission on Intergovernmental Relations names the Indiana University **Center for Urban Policy and the Environment** to administer the commission.

The mission of the Indiana University Center for Urban Policy and the Environment, as a part of the **School of Public and Environmental Affairs,** is to work with state and local governments and their associations, neighborhood and community organizations, community leaders, and business and civic organizations in Indiana to identify issues, analyze options, and develop the capacity to respond to challenges. The Center's expertise is available to provide research and analysis of policy issues, develop community consensus, offer implementation assistance, and evaluate outcomes and outputs.

# INDIANA’S MARKET VALUE ASSESSMENT STUDY

The property tax has long been the primary revenue source for local governments in Indiana, as it is in every state in the U.S. In 1995, the statewide property tax levy was over $4.4 billion. After state property tax replacement credits, net tax revenue was over $3.7 billion, or about $650 per capita. In comparison, the state personal income tax and general sales tax each raised about $2.8 billion, which is about $490 per capita.

## THE STUDY

Public Law 63-1993 requires the State Board of Tax Commissioners to study the impact of converting the current property tax assessment system to a system based on fair market value. Section 3 of the law cites three topics for study: (1) the fiscal, legal, and administrative impact of conversion to fair market value assessment on state and local government; (2) the fiscal impact on the owners of the various classifications of property in Indiana; and (3) the assessing system, including methodology, structure, and procedure, in states that use a property tax assessment system based on fair market value. The study is to be completed on or before December 1, 1996, and is to include a report of results and the Tax Board's recommendations for implementing a fair market value system, should the legislature be called upon to do so.

In the summer of 1995 Larry DeBoer, professor of agricultural economics at Purdue University, was named director of the study. Members of the study team include David Good, associate professor of public finance and policy analysis at Indiana University; Craig Johnson, assistant professor of public finance and policy analysis at Indiana University; and Joyce Man, assistant professor of public finance and policy analysis at Indiana University-Purdue University Indianapolis (IUPUI).

## BACKGROUND

Under Indiana’s current assessment system, the State Board of Tax Commissioners provides rules to determine property values for tax purposes, known as true tax value. Assessed value is one-third of true tax value. True tax value is determined using the sales comparison method for land and replacement cost less depreciation for structures. Indiana code 6-1.1-31-6(c) states that ". . . true tax value does not mean fair market value." Instead, true tax value is defined as "the value determined under the rules of the State Board of Tax Commissioners." Indiana’s replacement cost method does not link assessed value to market value, so assessments do not necessarily bear any relation to market values.

The Indiana Tax Court found that the Indiana’s true tax value assessment system is unconstitutional, and giving the tax board and state legislature until March 1998 to bring the system into compliance with the constitution.

Article 10, Section 1(a) of the Indiana Constitution states:

> "The General Assembly shall provide, by law, for a uniform and equal rate of property assessment and taxation and shall prescribe regulations to secure a just valuation for taxation of all property, both real and personal."

In 1995 the Indiana Civil Liberties Union sued to have the true tax value assessment system overturned. Judge Fisher of the Indiana Tax Court published his decision on May 31, 1996, finding that the Indiana’s true tax value assessment system is unconstitutional, and giving the tax board and state legislature until

March 1998 to bring the system into compliance with the constitution. At this writing the state has not decided whether to appeal the decision to the Indiana Supreme Court. If this decision stands, the General Assembly will have to change the assessment system during the 1997 session.

## MARKET VALUE

The International Association of Assessing Officers (IAAO) defines market value as:

> "the most probable price expressed in terms of money that a property would bring if exposed for sale in the open market in an arms-length transaction between a willing seller and a willing buyer, both of whom are knowledgeable concerning all the uses to which it is adapted and for which it is capable of being used."

PL63 defines fair market value as a system that uses sales of comparable properties, income capitalization, and reproduction cost information to determine the valuation of property for tax purposes. Market value systems generally use comparative sales to value residential property, and other properties that sell frequently. But market value systems also rely on replacement cost and income capitalization methods for properties which change hands infrequently, as well as for unique properties.

## SALES PRICE DATA COLLECTION

PL63 provides for the collection of sales data through the use of sales disclosure forms. These forms are filed with the county auditor when property is sold, and reveal the sales price and other details about the property. Forms are conveyed to the State Tax Board, where they are converted into computer readable form for use by the study team. The Tax Board has received more than 600,000 sales disclosure forms, and converted them to computer readable form. Several thousand forms are added to this data base each month.

Sales disclosure data are not public information and may be used only for the purposes of the study. Use of the forms expires July 1, 1997. Should the legislature adopt market value assessment, however, sales price data will continue to be needed and the sales disclosure requirement would likely become permanent.

## TAX BURDEN SHIFTS

A principle concern about changing to market value assessment is how tax burdens will shift. The study will estimate tax burden shifts by first matching sales prices from the disclosure forms with characteristics of properties. Characteristics of houses, for example, might include size, age, features such as garages or swimming pools, and location factors such as proximity to retail centers or environmental nuisances. Property characteristics will be taken from existing property record cards, and from Census and other data sources. Counties will be asked to provide property record card data in machine readable form for this purpose. Unfortunately, delays in the completion of the current reassessment have delayed acquisition of this data by the project.

Statistical methods will develop equations that relate sales prices to property characteristics. These equations will be used to estimate the market value of residential and some commercial properties. Replacement cost methods will be used to estimate market values for properties that have few comparable sales, such as industrial and many commercial properties. The estimated market value assessments will be summed by taxing unit, and market value tax rates will be calculated using current tax levies. Market value assessments and tax rates will be used to calculate tax payments by residential, commercial, industrial, and agricultural taxpayers in many localities around the state. A comparison to current tax payments will show tax burden shifts.

This part of the study will serve two purposes. First, it will show which types of taxpayers would pay less, and which would pay more, if market value assessment were adopted. Second, it will provide a prototype market value system for the Tax Board.

## POLICY OPTIONS

The study will present the legislature with information on the effects and costs of several policy options. For example, almost all market value states use some form of "use value" assessment for farm land. Farm land is assessed at its value in agriculture, not its potential value if developed for residential, commercial, or industrial use. The study will compare tax burden shifts if farm land is assessed at its market value, and at its use value.

As another example, many states assess different classes of property (residential, industrial, commercial, etc.) at different percentages of market value. Such classification could have important effects on the direction and size of tax burden shifts. The study will analyze the impacts of various classification schemes on tax burden shifts and economic incentives. Note that in Indiana classification would probably require a Constitutional amendment. Further, it is not yet clear how much latitude the Tax Court decision gives the legislature to modify market value for policy purposes.

## FISCAL AND ECONOMIC IMPACTS

The tax burden shifts described above show "legal incidence," changes in the tax bills paid directly by taxpayers. But changes in tax payments on businesses may be shifted to customers through changes in product prices, or to employees through changes in wages and benefits. The study will estimate this "economic incidence" of a shift to market value.

One characteristic of a property is its property tax payment. If the tax on a property rises, it may sell for less; if the tax falls, it may sell for more. Taxes may be capitalized into prices. The study will estimate how property prices might change with changes in taxes induced by a shift to market value assessment.

The property tax has been a stable revenue source for local governments. The true tax value system, with infrequent reassessments, may be one source of this stability. A move to market value, with more frequent reassessments, may affect the stability and growth of assessed value. This could in turn affect the stability and growth of the tax levy and/or tax rates. The study will estimate how a move to market value assessment will affect the stability and growth of the property tax base.

Indiana's school aid formula and property tax controls are based in part on assessed values. The study will investigate how a move to market value would affect existing formulas, and how the formulas could change to leave current results unaltered. Among the other fiscal and economic impacts to be studied are the effect on economic development tools such as tax increment financing and bonding for local capital expenditures.

## ADMINISTRATION

A shift to market value assessment may require changes in the operations of the State Tax Board and local assessors. For example, many market value states conduct annual equalization studies to monitor the relationship between assessed values and market values in localities around the state. Property data collection could change, if market value assessment requires measurements of property characteristics different from true tax value assessment. The statistical equations relating property characteristics to sales prices will require periodic updates.

Local assessors are being surveyed in May and June 1996 to gather information on training, the administration of local offices, and assessor opinions about market value assessment. The study will gather information on assessing practices used in market value states, to evaluate the alternate procedures that could be used to administer market value assessment.

## FINDINGS

PL63 requires that the study be completed by December 1, 1996. The law does not identify the committee to which the study team will report. The study team will stand ready to assist the legislature during its consideration of market value assessment during the 1997 session. It is likely that new policy proposals will emerge during this debate. If the legislature requests, these will be analyzed by the study team using the results and models developed in the initial report.