Coates' Canons Blog: The Revenue-Neutral Tax Rate

By Chris McLaughlin

Article: https://canons.sog.unc.edu/the-revenue-neutral-tax-rate/

This entry was posted on June 30, 2011 and is filed under Finance & Tax, Property Taxes

The revenue-neutral tax rate is a bundle of contradictions. It is intended to make the property tax reappraisal and rate-setting process more transparent, but instead it often muddies the waters. The rate is required to be calculated and published by local governments but need not actually be adopted for the coming fiscal year. If adopted, the rate is revenue-neutral for the county as a whole but not for individual taxpayers. In a nutshell, the revenue-neutral rate is complex, confusing, and unavoidable. Here are some tips to minimize problems associated with the revenue-neutral tax rate and maximize its usefulness.

What is the revenue-neutral tax rate ("RNTR") and why does it exist?

NCGS 159-11(e) defines the RNTR and requires that it be included in the proposed budget submitted by the finance officer to the governing board "for comparison purposes" in reappraisal years. Counties (and therefore the municipalities in those counties) must conduct reappraisals of real property at least every eight years. Most counties are on four- or eight-year reappraisal cycles.

When a reappraisal occurs, the tax base for that county and its municipalities changes because real property values are pegged back to market value. (Or at least that's the goal.) In "normal" economic times, the real property tax base increases after a reappraisal, usually between 20% and 40% depending on how long it's been since the county's last reappraisal. These are not normal economic times, sadly, and for the first time ever we are seeing multiple counties experience decreases in their tax bases after reappraisals. (Click here for a related post.)

When the tax base changes, that local government would experience a change in revenue if its tax rate were to remain unchanged for the new fiscal year. The RNTR is intended to show the tax rate that would keep the local government's revenue neutral given its new tax base. Well, not exactly neutral: the statutory calculation increases the current year's revenue by the average annual growth rate experienced by the local government's tax base since the last reappraisal. (I told you it was complex. Click here and here for bulletins explaining the gory details of the RNTR calculation.)

If the tax base increases due to the reappraisal, the RNTR will be lower than the current tax rate. If the tax base decreases due to the reappraisal, the RNTR will be greater than the current tax rate.

How does the RNTR affect taxpayers?

The RNTR must be published but it need not be adopted. If the local government adopts a tax rate greater than the RNTR—even if the new tax rate is *lower* than the current tax rate—then it effectively increases its revenues and increases the tax burden on its citizens.

Taxpayers often have difficulty accepting the fact that their individual tax bills still may increase even if the local government adopts the RNTR. The "revenue-neutral" aspect of the RNTR refers to the aggregate tax burden for the entire jurisdiction, not the tax burden for individual taxpayers. If a taxpayer's real property appreciated in value more than did the local government's real property in the aggregate, then that taxpayer's tax bill will increase if the RNTR is adopted.

A taxpayer's bill will also increase if that taxpayer's proportion of real property to personal property is greater than that for the jurisdiction as a whole. When real property market values are rising each year, a reappraisal effectively shifts more of a local government's tax burden from personal property (which is pegged to market value every year) to real property (which lags behind market value in between reappraisal years). As a result, adopting the RNTR will increase aggregate taxes on real property and decrease aggregate taxes on personal property. A taxpayer who owns only real property (or real property and low value personal property) will experience a tax increase even if the RNTR is adopted.

What happens if aggregate real property tax values *drop* after a reappraisal? Last year, a few beach towns in Onslow County suffered 40% decreases in real property tax values. This year, tax value depreciation occurred this year in several counties, including Lincoln County (6% decrease) and Carteret County (22% decrease). In all of these jurisdictions the RNTR was *greater* than the existing tax rate, meaning that elected officials needed to raise the tax rate for the coming fiscal year simply to keep revenues neutral.

Not all properties within those jurisdictions experienced the same depreciation, of course. In both absolute and relative terms, expensive properties, especially vacation homes, lost much more value than did more modest properties. Many modest homes maintained or even gained tax value after the reappraisal—meaning that an increased tax rate would dramatically shift the property tax burden from more expensive homes (often owned by people who live and vote elsewhere) to more modest homes (often owned by people who live there, vote there, and can least afford a tax increase). The political and economic consequences of conducting reappraisals in a recession convinced 12 of the 23 counties that were scheduled to reappraise real property in 2011 to postpone those efforts.

Education is key

Budget, finance and tax officials facing a reappraisal year should take care to educate both the governing board and their taxpayers about what the RNTR is and isn't. Counties may wish to create something similar to this detailed RNTR explanation that Pete Rodda and the Forsyth County Tax Office published in preparation for their 2005 reappraisal. Equally important is outreach to local media to discuss the impact of the reappraisal and the RNTR before new tax values and new tax rates hit the news. Without such efforts, confusion and consternation is likely among elected officials and the public.

Links

- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=159-11
- canons.sog.unc.edu/?p=2978
- sogpubs.unc.edu/electronicversions/pdfs/lfb39.pdf
- ncinfo.iog.unc.edu/pubs/electronicversions/pdfs/lfb32.pdf
- canons.sog.unc.edu/wp-content/uploads/2011/06/forsyth_county_revenue_neutral_explanation1.pdf