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THE COOK COUNTY PROPERTY TAX SYSTEM AND FUNDAMENTAL PRINCIPLES OF TAXATION

A Primer that Applies Fundamental Tax Principles to the Cook County Property Tax System

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The Civic Federation is an independent, non-partisan government research organization working to maximize the quality and cost-effectiveness of government services in the Chicago region and State of Illinois.

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INTRODUCTION

This report describes basic principles of taxation and evaluates how these principles are manifested in the Cook County property tax system.[1] While this discussion draws on the considerable academic literature on taxation, it does not capture all of the points currently debated by tax economists. It also acknowledges the political relevance of the public perception of a tax, even when that perception does not match the reality of how the tax operates and who bears the burden of taxation.

The following discussion outlines four basic criteria by which to judge a tax system: equity, simplicity, neutrality, and revenue adequacy. An evaluation of the extent to which the Cook County property tax system adheres to these principles is noted in a box at the end of each section. The reader should note that while a comprehensive evaluation of all taxes and fees imposed in Cook County is beyond the scope of this report, the property tax is only one component of the total tax system. A principle of taxation that is violated by the property tax may well be upheld by other taxes in the system.

The purpose of the report is descriptive, not prescriptive. It examines the operation of basic tax principles in the Cook County property tax system but does not recommend changes to that system.

[1] Unless otherwise noted, the term "property tax" as used here refers only to a tax on real estate, not on personal property.

EQUITY

First and foremost, a tax system should be fair. The difficulty is in defining "fair" or "equitable." The following section describes three principles of fairness in taxation: the benefit principle, the ability-to-pay principle, and uniformity.

Benefit Principle

The benefit principle states that a fair tax system is one where only those people who benefit from a particular government service[2] pay taxes to support that service. Government services financed by user fees, such as public utilities and toll roads, follow the benefit principle. Taxes earmarked for related purposes, such as motor fuel taxes used to build and maintain public highways, also arguably follow the benefit principle. A clear link between the tax and the benefit does much to quell anti-tax sentiments, particularly when use of the service is voluntary.

A tax system based solely on the benefit principle is problematic for several reasons:

- The primary difficulty is measuring how much benefit is received by each individual, but there is also the problem of benefits that accrue to non-users. For example, motorists who do not use tax-supported public transit systems nonetheless benefit from reduced congestion on the roadways.
- There is also the problem of limiting "free riders" who do not pay for the government-provided public goods that they consume. Public goods are characterized by the fact that specific individuals cannot be prevented from consuming them—if provided to one, they are by definition provided to all. National defense is the classic example of such a public good. If payment were not mandatory, many people would choose to take a "free ride" and not pay for national defense knowing that it will still be provided even if they do not contribute to it. This would result in many people not paying their fair share and could lead to insufficient revenues for the service.
- Finally, if access to certain government services is considered to be a right of all citizens, then strict adherence to the benefit principle will prevent access by the poorest citizens, who cannot afford to pay for these services.

Some scholars have suggested that the property tax meets the benefit principle when one assumes that property owners "vote with their feet" by locating in jurisdictions that provide the specific level of taxes and services they desire, and this level of choice makes the property tax effectively a fee for service.[3] Others point out that while this may make it an "interjurisdictional" benefit tax, the property tax is still not an "interindividual" benefit tax

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[2] Throughout this report the term "government service" is meant to include tangible goods, such as roads and sewers, as well as services, such as police and education.

[3] William A. Fischel, "Municipal Corporations, Homeowners, and the Benefit View of the Property Tax," in *Property Taxation and Local Government Finance,* Wallace E. Oates (ed.), (Cambridge, MA: Lincoln Institute of Land Policy, 2001), 33-77. See also chapters 2, 3, and 11 of that volume.

because different taxpayers within the same jurisdiction consume different amounts of government services.[4]

In practice, there are several obstacles to "vote with your feet" benefit sorting of taxpayers. Perfect mobility is limited by factors such as zoning restrictions, social and cultural ties, and employment opportunities.[5] Not everyone has the ability to move to a jurisdiction that provides the mix of taxes and services they desire, so the unequal distribution of property wealth among communities does create legitimate inequities. Differences in the level of services such as street repair or park amenities are one thing, but there is typically much greater public concern about jurisdictional disparities in K-12 education resources. Many court cases and property tax reform initiatives nationwide have originated from charges that the property tax creates unacceptable inequality in the public school finance system.[6] A completely centralized tax system for public education may distribute education dollars more equitably, but at the expense of local control over education funding and administration.

The Cook County property tax system only loosely adheres to the benefit principle through the geographic segregation of the tax and certain local services: local taxpayers pay for the public schools, streets and police in their communities.

All local property owners benefit from public goods such as fire protection, disease control, and an educated society. They also benefit from property value appreciation attributable to high quality government services that make communities attractive to buyers.

However, there are clearly differences in the amount of direct government service received by different taxpayers in a community, for example by those who have children in the public schools and those who do not, since over half a typical property tax bill goes to fund public schools.[7] Furthermore, the size of tax payments varies according to the assessed value of property, not according to amount of benefit received.[8]

There are also significant interjurisdictional differences in tax base available to fund local government services, most notably education. This is problematic because people do not have complete freedom to move to communities that provide the mix of taxes and services they desire.

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[4] Richard A. Musgrave, "Commentary," in *Property Taxation and Local Government Finance,* Wallace E. Oates (ed.), (Cambridge, MA: Lincoln Institute of Land Policy, 2001), 338-342.
[5] Therese J. McGuire, "Alternatives to Property Taxation for Local Government," in *Property Taxation and Local Government Finance,* Wallace E. Oates (ed.), (Cambridge, MA: Lincoln Institute of Land Policy, 2001), 308.
[6] For a history of education-related property tax litigation see William N. Evans, Sheila E. Murray, and Robert M. Schwab, "The Property Tax and Education Finance: Uneasy Compromises," in *Property Taxation and Local Government Finance,* Wallace E. Oates (ed.), (Cambridge, MA: Lincoln Institute of Land Policy, 2001), 210-235.
[7] Education is a public good, such that everyone benefits from living in a society where people are educated. All property owners also benefit from the increased property values created by a high quality public school system. However, parents of children attending public schools clearly receive a direct and quantifiable benefit that is not also enjoyed by people without children in the public schools.
[8] An exception to this is Special Service Areas, where local property owners choose to pay an additional property tax for specific supplemental services.

Finally, there are many commuters and visitors to Cook County who benefit from the provision of property-tax supported government services but do not pay property taxes to the county.

Ability-to-Pay Principle

The ability-to-pay principle states that a fair tax system is one in which those most able to bear the cost contribute the most toward government services. In other words, affluent individuals pay more to support government than less affluent individuals, regardless of who enjoys the benefits or how much of a service is consumed by different socio-economic groups. The goal is to assign equivalent burdens to people of different means.

There are several difficulties in implementing the ability-to-pay principle:

- First, one must first decide how to determine ability to pay. There is no scientific way to directly measure relative sacrifice, so a proxy must be selected. Historically, ability to pay was typically measured according to the amount of productive land and property owned (e.g., livestock, equipment, buildings), since wealth was derived from such tangible assets. In modern developed societies, current income is usually considered a better gauge of ability to pay because most individuals earn wages rather than produce food and significant amounts of wealth take the form of intangible assets such as stocks and bonds. The introduction of federal and state income taxes during the 20th century reflected this growing belief that income was the best proxy for ability to pay. However, there are ongoing debates as to whether total net wealth or household consumption would be superior measures of ability to pay.[9] The sales tax, for example, arguably follows the ability-to-pay principle on consumer purchases in excess of basic necessities since additional purchases are only made if one has the ability to pay for them.

- A second issue to consider is how the tax burden should be distributed among individuals of different means. Should it be exactly proportional to pre-tax ability to pay, or should it place a greater relative burden on people of greater means? The notion of **vertical equity**, or the relative tax burden on people of different abilities to pay, addresses this aspect of fairness. A standard metric of relative tax burden is the effective tax rate, which is the tax amount divided by the tax base. The three types of vertical equity are:
  1) regressive: where people of lesser means have a higher effective tax rate,
  2) proportional: where everyone has the same effective tax rate; and
  3) progressive: where people of greater means have a higher effective tax rate.

The decision about which type of vertical equity should be established is an important social aspect of tax policy, since both regressive and progressive systems have a redistributive effect in different directions.

Vertical equity can also apply to property assessments. If lower-priced properties are overassessed as compared to higher-priced properties, regressive assessment is occurring. Regressive assessment can happen for a number of reasons, including less frequent sales of higher-priced properties, which may make it more difficult for an assessor to maintain accurate

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[9] See for example Robert Murray Haig, *A History of the General Property Tax in Illinois* (Champaign: University of Illinois, 1914), and John L. Mikesell, *Fiscal Administration: Analysis and Applications for the Public Sector* 6th edition (Belmont, CA: Wadsworth/Thomson Learning, 2003), 289.

market values.[10] The vertical equity of assessments can be measured with an index called the price-related differential (PRD), calculated by dividing the mean assessment ratio by the weighted mean ratio. A PRD over 1.0 indicates regressive assessment, while a PRD under 1.0 indicates progressive assessment, where lower-priced properties are underassessed relative to higher-priced properties.[11] According to the International Association of Assessing Officers, a PRD should be between 0.98 and 1.03.[12] The PRD for Cook County residential property has been close to the IAAO standard but slightly regressive, ranging from a low of 1.02 to a high of 1.09 during tax years 2000-2007.[13]

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[10] Arnold H. Raphaelson, "The property tax" in Richard J. Aronson and Eli Schwartz, eds., *Management Policies in Local Government Finance*, 5th edition. (Washington, D.C.: International City/County Management Association, 2004), 271.
[11] International Association of Assessing Officers, *Standard on Ratio Studies* (July 2007), 14.
[12] International Association of Assessing Officers, *Standard on Ratio Studies* (July 2007), 19.
[13] Illinois Department of Revenue Assessment Ratios, various years.

Public Perception vs. Economic Reality

It is important to recognize the significant differences between public perception and economic realities of property taxation. While lawmakers and taxpayers routinely call the property tax regressive,[14] a number of scholars now argue that the property tax is in fact progressive when it is viewed as a national tax on capital.[15] The argument is that because nearly all communities in the country tax capital (in the form of real property), and higher-income households own a disproportionate share of capital nationwide, the property tax is progressive overall.[16] Nonetheless, local property tax rates differ significantly so while the property tax might be progressive nationwide, it can be quite regressive in certain communities with high tax rates and low property values.[17]

The term "regressive" is commonly used in public discourse as a synonym for "unfair" regardless of the actual vertical equity of the tax.[18] Conversely, the public does not always denounce obviously regressive taxes. For example, tobacco and alcohol taxes are rarely called "unfair" despite their regressivity among consumers of these products, while the highly progressive estate tax is vilified by its opponents for being unfair. As Youngman (2002) notes, public perception of fairness often hinges on people believing that they have a choice about whether or not to pay the tax. The relatively regressive general sales tax[19] is often less objectionable to taxpayers than even the progressive federal income tax because of the perception of control: one can choose whether or not to make certain purchases.[20] The political power of perceived tax fairness cannot be overstated. The majority of "tax relief" proposals are crafted in response to this perception, regardless of reality.

Taxpayers are most accepting of taxes that "feel fair" even if they fail various economic criteria for fairness,[21] so it is important for tax policy makers to consider this perception and attempt to educate the public when the actual equity of a tax diverges from the perceived equity. For example, even if we assent to the view that the property tax is a progressive tax on capital, most taxpayers will continue to gauge their own ability to pay in terms of their current income. Homeowners who experience financial hardship or whose incomes rise less rapidly than their property tax bills may eventually need to sell their homes and move to lower value residences or

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[14] See Joan M. Youngman, "Enlarging the Property Tax Debate—Regressivity and Fairness," *State Tax Notes*, 7 (October 2002): 45-52.

[15] George R. Zodrow, "The Property Tax as a Capital Tax: A Room with Three Views," *National Tax Journal*, 54, no. 1 (March 2001): 139-156.

[16] Wallace E. Oates, "Property Taxation and Local Government Finance: An Overview and Some Reflections," in *Property Taxation and Local Government Finance,* Wallace E. Oates (ed.), (Cambridge, MA: Lincoln Institute of Land Policy, 2001), 23.

[17] Richard A. Musgrave, "Commentary," in *Property Taxation and Local Government Finance,* Wallace E. Oates (ed.), (Cambridge, MA: Lincoln Institute of Land Policy, 2001), 339-340.

[18] See Joan M. Youngman, "Enlarging the Property Tax Debate—Regressivity and Fairness," *State Tax Notes*, 7 (October 2002): 45-52.

[19] Exempting basic necessities such as food and medicines from the general sales tax can mitigate its regressivity.

[20] See Joan M. Youngman, "Enlarging the Property Tax Debate—Regressivity and Fairness," *State Tax Notes*, 7 (October 2002): 50-52, on public perceptions of various taxes.

[21] Patrick Doherty, "Collection of Local Taxes," *Journal of Property Tax Assessment & Administration* 31, no. 4, (1999): 35-36, cited in Youngman p. 52.

lower tax rate jurisdictions. The gentrification that occurs when people are thus "taxed out of their homes" is met with substantial ambivalence. Residents may enjoy capital gains from the sale of their property, yet be distressed by having to leave a community. Elected officials, likewise, are both encouraged by rising property values in their jurisdictions and troubled by the displacement of their constituents.

Tax Incidence

Discussion of tax equity also requires an awareness of tax incidence, or who actually pays the tax. Tax laws dictate who owes the tax, but they cannot control the actual tax incidence because tax burdens can be shifted. For example, the landlord of an apartment building is legally responsible for remitting property taxes, but the actual tax incidence falls partially, if not entirely, on the tenants paying rent. It is important to understand that although lawmakers often favor taxing businesses over taxing individuals for political reasons, all taxes are ultimately paid by actual people. A tax on business can be shifted in three directions:

1) forward: to consumers in the form of higher prices;
2) backward: to employees and suppliers in the form of reduced payments (supply or labor cuts); and
3) absorbed: by owners in the form of reduced profits.

The direction of tax shift is typically determined by what is being taxed and by market conditions but it is always passed on to people, be they consumers, employees, suppliers, or owners. In addition to the perception that business taxes reduce the tax burden on individuals, another political benefit of business taxes is that they can sometimes export the tax incidence to individuals outside the taxing jurisdiction. For example, a local property tax paid by a multinational corporation may have actual incidence on owners, employees, and consumers worldwide. However, excessive taxes on business can impair the competitiveness of local businesses and drive businesses out of the jurisdiction.

Tax incidence is also shifted among taxpayers when the total tax revenue is a zero sum game and special treatment is afforded to certain taxpayers. The Cook County property assessment classification system, exemptions for charitable and religious properties, homeowner exemptions, senior exemptions, and veterans' exemptions all have the effect of shifting property tax incidence among different types of taxpayers.[22]

There is considerable debate about the extent to which the Cook County property tax system adheres to the ability-to-pay principle. In previous centuries when the U.S. economy was largely agrarian, property (real, personal, tangible and intangible) was widely considered the best measure of ability to pay, thus the property tax met this principle.[23] The introduction of sales taxes and income taxes at the turn of the 20th century reflected a recognition that, as the economy changed, property value was no longer an adequate proxy for wealth as it once had been. Many people now believe that the property tax ignores the ability-to-pay principle because it is not directly related to a taxpayer's current cash income, and increases in assessed property value represent unrealized capital gains. Others argue that because property value is a component of overall wealth, the property tax does follow

[22] See the Civic Federation's *Cook County Property Assessment Process* and *Cook County Property Tax Extension Process* (forthcoming).

[23] See for example Robert Murray Haig, *A History of the General Property Tax in Illinois*, (Champaign: University of Illinois, 1914); Henry J. Aaron, *Who Pays the Property Tax?* (Washington, D.C.: Brookings Institution, 1975); and Glenn Fisher, "History of Property Taxes in the United States," EH.Net Encyclopedia, edited by Robert Whaples. October 1, 2002. http://eh.net/encyclopedia/article/fisher.property.tax.history.us

the ability-to-pay principle regardless of current income, and the definition of ability to pay should include income over the long term. The introduction of means-tested exemptions, such as the Senior Citizens Assessment Freeze Homestead Exemption passed by the Illinois General Assembly in 1994 and the Long-Time Occupant Homestead Exemption passed in 2007,[24] reflect the belief that a strict *ad valorem* ("according to value") tax on real property does not meet the modern standard of current income as the most acceptable measure of ability to pay.

There is also ***disagreement about the vertical equity of the property tax system***, particularly as related to residential property. There is a popular belief that the portion of income spent on housing declines as income rises, thus a strict *ad valorem* real property tax is regressive with respect to income. However, academic studies have produced contradictory findings on the extent to which housing expenditures are proportional to income at different income levels,[25] and the vertical equity of property taxes in a specific jurisdiction is an empirical question that could be answered by a thorough computation of the effective tax rate for each taxpayer. From a benefit principle perspective, the property tax is actually progressive to the extent that owners of greater property wealth pay more for the same government services (fire, police, schools, etc.) than do owners of lesser property wealth.

[24] The Long-Time Occupant Homestead Exemption (35 ILCS 200/15-177) is an addition to the "7% cap" law that provides for expanded homeowner exemptions for long-time homeowners with household incomes under $100,000.

[25] See for example: Elizabeth Plummer, "Evidence on the Incidence of Residential Property Taxes Across Households," *National Tax Journal, Vol. LVI, No.4* (December 2003): 739-753; Jack Goodman, "Houses, Apartments, and the Incidence of Property Taxes," *Housing Policy Debate,* 17 n. 1, (Fannie Mae Foundation 2005): 1-26; Daniel Fernández-Kranz and Mark T. Hon, "A Cross-Section Analysis of the Income Elasticity of Housing Demand in Spain: Is there a Real Estate Bubble?" *Journal of Real Estate Finance and Economics*, *32* (2006): 449-470; and Joan M. Youngman, "Enlarging the Property Tax Debate—Regressivity and Fairness," *State Tax Notes*, 7 (October 2002): 45-52.

Uniformity

Uniformity is a type of tax equity that is synonymous with horizontal equity, where two taxpayers receiving equal benefits or of equal means should owe the same tax. In other words, taxpayers should not be arbitrarily discriminated against, and taxes should be assessed in a consistent, objective manner. The property tax does not achieve perfect horizontal equity of benefits because as discussed above, there is not a direct relationship between the quantity of benefits received and the amount of taxes paid.

The horizontal equity of property assessments is of utmost importance in property taxation and the lack of uniform valuation was a major problem in the early history of the United States. In 1818, Illinois was the first state to adopt a uniformity clause in its constitution.[26] Although the 1970 Illinois Constitution permitted the classification of property in counties with more than 200,000 residents, it maintained that assessments must be uniform within classes.

Uniformity of assessment demands that like properties have like assessments and is difficult to achieve for a variety of reasons:

- First, uniformity requires a common assessment method, or way to determine the value of a property for the purpose of taxation. Many assessors use data on sales of comparable properties (called a market-data or sale comparison approach) in order to value residential properties because there are normally enough sales transactions to provide reliable data for comparison. However, for income-generating properties such as commercial, agricultural, and rental real estate, it is common to use an income approach that also considers future income and expenses related to the property. Properties that rarely change hands may best be assessed using a cost approach that estimates the cost of reproducing or replacing the building and factors in depreciation. There are ongoing debates over the most fair and appropriate valuation techniques for various types of properties.[27]

- Regardless of the method chosen, few properties are perfectly identical and the subjective element of valuation leads to differences of opinion among assessors and appraisers.

- It is rarely possible for assessors to physically evaluate each parcel, so they must rely on data collected through property transfer documentation, permitting, and sample site visits. Uniform valuation of a large number of properties is facilitated by techniques such as multiple regression, which benefit from technological improvements that permit high volume statistical computations.

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[26] Glenn W. Fisher, *The Worst Tax? A History of the Property Tax in America* (Lawrence: University of Kansas Press, 1996), 57.

[27] See the Civic Federation's *Cook County Property Assessment Process: A Primer on Assessment, Classification, Equalization and Property Tax Exemptions*, April 5, 2010, http://civicfed.org/sites/default/files/100405_CookCountyAssessmentPrimer.pdf.

A common metric for the degree of uniformity achieved is the **coefficient of dispersion** (COD) computed in an assessment/sales ratio study. An assessment/sales ratio study compares the assessed values with the sales values of properties that were sold in a given time period. The median assessment/sales ratio is the median of all individual ratios within a given geographic area or property type. The coefficient of dispersion indicates how closely individual ratios are grouped around the median assessment/sales ratio. It is the average absolute (negative or positive) deviation of individual ratios from the median.

A low COD indicates relatively high uniformity within the stratum, group or class of property for which the statistic is calculated. It is important to understand, however, that this does not necessarily mean that such a stratum, group or class of property has been assessed in compliance with constitutional or statutory requirements, or that it is free from arbitrary discrimination in comparison with other similarly situated strata, groups or classes.

The International Association of Assessing Officers (IAAO) recommends standards for coefficients of dispersion based on property type and location. According to the IAAO, a coefficient of dispersion under 15% is generally an acceptable level of uniformity for an urban residential area.[28] Rural areas typically have fewer residents and fewer sales, so a larger COD is tolerated. The Illinois Property Tax Code reflects these standards by providing assessors of areas with at least 50,000 residents a $3,000 performance bonus for achieving a COD of 15% or less. Assessors of less populated areas are eligible for the bonus if they achieve a COD of 30% or less.[29]

The Illinois Department of Revenue's 2007 assessment ratios for Cook County show a countywide COD of 64.76% for vacant land, 16.08% for residential properties, 70.37% for apartments, 46.47% for commercial properties, and 44.36% for industrial properties.[30] Residential CODs have been fairly consistent over the last ten years, ranging from 15 to 18%. The high CODs for vacant, apartment, commercial, and industrial properties are due in part to the relatively small number of sales of these types of properties, as compared with residential sales.

Given the difficulty of achieving uniformity, it is important to have an efficient and effective system whereby owners can appeal their valuations if they believe they have not been assessed fairly or uniformity has been violated.[31]

The Cook County property tax system fails to achieve horizontal equity for the benefit principle, since taxpayers pay different amounts for the same levels of service. However, a well-administered property tax system can achieve a great degree of uniformity in assessments, with like properties assessed at nearly the same level. The Cook County Assessor achieves reasonable countywide uniformity among residential assessments as

[28] International Association of Assessing Officers, *Standard on Ratio Studies* (July 2007), 17.
[29] 35 ILCS 200/4-20. The statute excludes Cook County from the bonus program.
[30] See http://www.revenue.state.il.us/Publications/LocalGovernment/PtaxStats/2007AssessmentRatios.pdf. "Residential properties" are single-family homes and rental properties with six units or fewer.
[31] For more avenues to appeal, see Civic Federation, *Cook County Property Tax Appeals: A Primer on the Appeals Process with Comparative Data for 2000-2008* (Chicago: November 17, 2009).

measured by the assessment/sales ratio coefficients of dispersion compiled by the Department of Revenue, albeit at an assessment level significantly lower than required by statute prior to 2009. Assessment of other types of Cook County properties is much less uniform as judged by coefficients of dispersion, but this is due in part to the lower number of sales of such properties. There are multiple avenues for appeal available to Cook County property owners who believe their properties have not been assessed in the same way as other like properties. However, the ***assessment of property in Cook County violates overall uniformity by using a classification system that legalizes the assessment of different types of property at different levels.***

SIMPLICITY

A tax system should be simple enough that taxpayers can understand it, collectors can easily administer it, and lawmakers can be held accountable for it.

Taxpayers have a right to understand what is being taxed, the mechanisms by which the tax is calculated and collected, and where the revenue goes. This understanding also promotes tax compliance. A complex tax system creates an additional burden for taxpayers, who may have to spend additional time or money to comply with the tax. Many tax systems are relatively simple at first but are made complex over time by the introduction of modifications to improve equity, special treatments for certain types of taxpayers, and mechanisms for limiting revenue collection.

Tax administrators should be able to easily compute and implement the tax. A complex tax system is inefficient because it demands a large amount of staff and/or equipment to administer, thus diminishing the net revenue and taking away resources from the services the tax is intended to fund. Simple tax systems are also more likely to be consistently and rapidly administered.

In a simple tax system, it is easier to identify the lines of political responsibility. A complex system that involves multiple elected officials to legislate or administer blurs lines of responsibility and makes it difficult for taxpayers hold the correct officials responsible for the tax system. It is also very difficult to model changes to complex tax systems, making it hard for lawmakers to understand the potential effects of tax law changes. Finally, a complex tax system makes it difficult for everyone to identify tax burden shifts among taxpayers that occur as a result of tax policy changes or real estate market conditions.

The Cook County property tax system is excessively complex. There are 498 separate local governments that levy property taxes in Cook County, and most taxpayers owe taxes to roughly a dozen of them.[32] Administration of the Cook County property tax function is handled by three different elected county officials (Assessor, Clerk, and Treasurer), leading to taxpayer confusion about whom to contact with questions or complaints about the tax.[33] The lines of responsibility are nearly impossible for ordinary taxpayers to discern, and politicians exploit this fact to their political advantage. Decades of adding special treatments and revenue limitations have created a system that is fully understood by very few individuals and requires years of study. It is difficult for many levying agencies to understand and forecast their revenue limitations. Lawmakers routinely vote on property tax law changes without reliable estimates of their effects because comprehensive modeling is so time consuming and complicated. Tremendous private and public sector resources are devoted to deciphering, defending, and appealing various elements of the property tax system.

[32] There were 498 local governments levying property taxes in Cook County in 2007. See Illinois Department of Revenue, http://www.revenue.state.il.us/Publications/LocalGovernment/PtaxStats/2007/index.htm

[33] There are also two additional agencies that hear property tax appeals, the Board of Review and Property Tax Appeal Board, as well as the courts. See Civic Federation, *Cook County Property Tax Appeals: A Primer on the Appeals Process with Comparative Data for 2000-2008* (Chicago: November 17, 2009).

NEUTRALITY

A neutral tax system is one that does not produce economic distortion. Economic distortion occurs when taxation alters market behavior, and is something economists suggest avoiding. Sometimes taxes are intended to alter behavior, however, and the economic distortion they create is seen as a socially desirable improvement on pure market-based decision-making. For example, high taxes on tobacco and alcohol are often intended in part to curb consumption of these products, even though achievement of this goal ultimately reduces tax revenues.

Economists generally see economic distortion as a negative effect of taxation because it interferes with market-based decision-making. For example, a high tax on a product will lead consumers to make purchasing decisions that are not solely based on the merits of the product, but are affected by the tax as well.[34] Taxes on labor costs can also influence employers' decisions about the number and type of employees to hire, and personal income taxes can affect workers' decisions about how much to work.

The most economically neutral taxes are universal, meaning that they have a broad base with no exemptions or deductions. When something is taxed the same in every jurisdiction the incentives to change behavior are reduced. Economic distortion is minimized by keeping tax rates low, taxing similar items or assets at the same rate, and reducing jurisdictional disparities.

It is extremely difficult, if not impossible, to measure the extent to which some features of a tax system affect individuals' decisions. Nonetheless, assertions about these effects are commonly heard in debates over property tax policy. For example, differences in business tax burdens are often cited as reasons why businesses have located in or left a given community, although there is little empirical evidence that property tax burden is a top factor in business location decisions.[35] All other factors being equal, a business would be expected to locate in a low-tax jurisdiction rather than a high-tax one, but major factors such as labor force, transportation, market size, and site availability often weigh much more heavily in site location decisions.[36]

Property taxes are "capitalized" into real estate values to the extent that knowledge of the future property tax burden affects the price a buyer is willing to pay. Some economists argue that capitalization distorts real estate decisions.[37] Others point out that the relationship between property value and local government services fosters taxpayer involvement and more efficient government. Homeowners have a vested interest in the provision of low-cost, high quality

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[34] The degree to which a high tax distorts behavior depends on the elasticity of demand for that product. The greater the elasticity, the more a high tax will distort behavior.

[35] Donald Haider, "Business Location, Taxes, and Property Taxes," (Chicago: Civic Federation, 1998) and John L. Mikesell, *Fiscal Administration: Analysis and Applications for the Public Sector*, 6th edition (Belmont, CA: Wadsworth/Thomson Learning, 2003), 305-306.

[36] Donald Haider, "Business Location, Taxes, and Property Taxes," (Chicago: Civic Federation, 1998).

[37] George Zodrow, "Who Pays the Property Tax?" *Land Lines* 18, no. 2 (April 2006).

government services because better roads and schools increase the value of their homes while higher taxes decrease their home values.[38]

The fact that owners receive explicit bills makes the property tax a **high-visibility tax**, in contrast to other taxes such as the sales tax, which is collected incrementally with every consumer purchase. This visibility provokes taxpayer interest in the cost of local government services and serves to better align those services with the demands of constituents.

The Cook County property tax system creates considerable economic distortion, much of which is intended. Differences in property tax rates, exemptions, and assessment levels influence people's decisions about types and uses of buildings to invest in and where to build or purchase them. But it is difficult if not impossible to determine the degree of influence these tax features have on real estate decisions. A variety of property tax incentive classes have been created in an attempt to influence business location and land use decisions, and policymakers continue to propose tax changes in an attempt to achieve policy goals. For example, the Cook County Assessor cited the higher assessment level of apartment buildings as a contributing factor in the rampant conversion of apartment buildings to condominiums, and subsequently proposed to lower the assessment level of apartment buildings in order to accomplish various policy objectives including slowing the condominium conversion rate.[39]

[38] William A. Fischel, "Municipal Corporations, Homeowners, and the Benefit View of the Property Tax," in *Property Taxation and Local Government Finance,* Wallace E. Oates (ed.), (Cambridge, MA: Lincoln Institute of Land Policy, 2001), 33-77.
[39] See Cook County Assessor James M. Houlihan, *Report and Recommendations on Multi-Family Property Assessment in Cook County*, Prepared for the Cook County Board of Commissioners (January 2006).

REVENUE ADEQUACY

It is important that a tax produce sufficient revenue to support the level of government services demanded by residents. Tax rates that are too low will not generate enough revenue, but as tax rates rise the incentive to avoid them increases. The point at which a rising tax rate begins to produce lower returns is considered the **economic capacity** of a tax.[40] However, taxpayers' ability to vote elected officials out of office creates a disincentive for lawmakers seeking to maximize tax revenues. Consequently, most taxes reach their political capacity well before their economic capacity. This is demonstrated by those home rule governments in Illinois that choose to self-impose a property tax extension limitation similar to that imposed by state law on non-home-rule governments.[41]

A tax should be easy to collect, with effective enforcement mechanisms. The property tax, for example, generally has a high collection rate because real estate is difficult to hide and liens can be placed against delinquent properties. A tax should also be stable, since excessive fluctuation in revenues disrupts the government's ability to provide a reliable level of service. Revenue stability is particularly important for state and local governments because it allows for predictability and better service-delivery planning.

The **elasticity** of a tax is a measure of how closely it reacts to changes in the economy. A highly elastic tax grows faster than the economy when economic activity is strong, but shrinks faster than the economy when economic activity is weak. An inelastic tax will remain relatively stable throughout the business cycle, but may not grow fast enough to support the rising costs of providing government services, or to meet increases in demand. In general, corporate and personal income taxes are the most elastic, sales taxes are moderately elastic, and property taxes are the least elastic.[42]

The Cook County property tax system is a stable and inelastic source of revenue for local governments. The collection rate is relatively high except in areas of extreme poverty, since state law provides for annual tax sales, where delinquent taxes are sold to purchasers who pay the tax in exchange for a lien against the delinquent property. Trend data demonstrate the stability, but also the inelasticity of property tax revenue, which has been largely limited since the introduction of the Property Tax Extension Limitation Law (PTELL) in 1995 to the lesser of 5% or the increase in the Consumer Price Index.[43]

The Cook County property tax system is an adequate source of revenue for some, but not all, local governments. Although PTELL has made it more difficult for many governments to increase property tax revenues without going to referendum, most governments receive sufficient revenue from property taxes to continue providing basic services. However, local

[40] For more on the tax-revenue relationship and Laffer curve see John L. Mikesell, *Fiscal Administration: Analysis and Applications for the Public Sector*, 6th edition (Belmont, CA: Wadsworth/Thomson Learning, 2003), 300-301.
[41] For example, see City of Chicago Municipal Code 3-92 and Cook County Code of Ordinances 74-38.
[42] John L. Mikesell, *Fiscal Administration: Analysis and Applications for the Public Sector*, 6th edition (Belmont, CA: Wadsworth/Thomson Learning, 2003), 300-301.
[43] See the Civic Federation's *Cook County Property Tax Extension Process* (forthcoming) for trend data on property tax revenue.

governments in extremely distressed communities are sometimes unable to generate enough revenue for basic government services. For example, in April 2008 the Cook County Sheriff began performing police patrols in the Village of Ford Heights, where more than half the residents are below the poverty line and the municipal government lacked the resources to adequately staff its police department.[44] There is also ongoing debate about whether local property taxes are adequate for funding school districts. The General State Aid formula provides relatively little funding for school districts where the real estate base can support a minimum level of per-pupil revenue, but provides more funding for communities that are unable to meet that foundation level through property taxes alone. In order to generate sufficient revenue without state assistance, the property tax rates in those communities would likely exceed their economic capacity.

[44] Matthew Walberg, "In absence of Ford Heights police, sheriff takes up slack," *Chicago Tribune* (April 22, 2008).

SUMMARY

The following is a summary of how well the Cook County property tax system follows basic principles of taxation.

Equity

- The Cook County property tax system loosely follows the benefit principle by its geographic nature of taxing local owners for local services, but there are large disparities between the benefits received and taxes paid by different taxpayers.
- There is considerable debate about the extent to which the Cook County property tax system follows the ability-to-pay principle, because the answer depends on whether or not one uses current income as the measurement of ability to pay. Various means-tested exemptions have been introduced in order to relate property taxation to current income.
- There is considerable debate about whether or not property taxes are regressive with regard to income, and some economists now argue that they are a progressive tax on capital. From a benefit principle perspective, the property tax is actually progressive to the extent that owners of greater property wealth pay more for the same services than do owners of lesser property wealth.
- The Cook County property tax system does not achieve horizontal equity because taxpayers pay different amounts for the same level of service. The Cook County Assessor's Office achieves reasonable countywide uniformity among residential assessments but the degree to which it achieves uniformity of assessments for other types of property is constantly challenged in the appeals system. The Cook County property tax system violates overall uniformity by legalizing a classification system that assesses different types of properties at different levels.

Simplicity

- The Cook County property tax system is excessively complex. There are many different governments and agencies involved in levying and administration of the tax, making lines of responsibility difficult for ordinary taxpayers to discern. Decades of adding special treatments and revenue limitations have created a system that is fully understood by few individuals.

Neutrality

- The Cook County property tax system creates considerable economic distortion, much of which is intended. It is extremely difficult if not impossible to measure the extent to which features of the property tax system affect individuals' and businesses' decisions about location and investment. Nonetheless, many property tax ordinances and laws are intended to affect these decisions.

Revenue Adequacy

- The Cook County property tax system is a stable and inelastic source of revenue for local governments.
- The Cook County property tax system is an adequate source of revenue for many, but not all local governments. Some communities with very low property wealth are unable to generate sufficient revenues for basic local government services.