

Factors Affecting the Property Tax: A Media Guide to Property Tax Systems



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This article describes some of the difficulties encountered in trying to effectively compare local and regional taxing systems, including the property tax. It is intended to explain why property tax systems are not necessarily directly comparable and why any comparisons should be evaluated carefully to ensure they are valid and unbiased.

State and local government in North America is traditionally funded from three primary tax sources: income tax, sales tax, and property tax. This triad of funding sources has been referred to as the *three-legged stool* for funding state and local government. (For a discussion of this topic, see, for example, *Principles of a High Quality State Revenue System* [National Conference of State Legislatures 2007].) Fees and charges are also widely used, often as less visible pressure relief valves when taxes or tax increases are deemed unpalatable. No comparison is complete without an analysis of these additional fees and charges.

Media reports abound with endless, creative, and sometimes complex variations on the balance between these funding sources, as lawmakers, advocacy groups, and tax-paying citizens seek ways to fund government through a fair and equitable system—one in which each taxpayer pays his or her fair share.

In the end, someone has to pay; otherwise, there will be no money to support fundamental government services, such as streets and sanitation services, public education, emergency services, and special projects in the community. The challenge is to find a solution acceptable to the tax-paying constituency without placing an undue burden on any one group or funding source.

The process of achieving that balance is a continual whirl of creative possibilities, all of which seem to have been tried in various combinations at some point. During these attempts at achieving balance, it is natural to examine what other jurisdictions are doing and to compare those approaches with the current mix of solutions being considered.

During difficult economic times, established economic concepts upon which government funding is based may be challenged more frequently by the media, the public, politicians, and policy makers.

When current funding solutions fail to meet real and perceived budgetary needs, there is a flurry of creative proposals about ways to continue funding government services from alternative sources. The media thrive on reporting the continuous speculation of lawmakers, the public, and special interest groups on different ways to obtain funding while maintaining some sense of fairness and balance.

Often, however, basic underlying presumptions about relative tax burdens and the relationship among changes in the economy, changes in property values, and changes in the amount of tax revenue that may result are wholly or partly incorrect. Even if presumptions are correct for one locality or region, they may be incorrect elsewhere and lead to incorrect comparisons or broad over-generalizations.

This article focuses on promoting a better understanding of the property tax—how it fits into intergovernmental finance and how it reacts to changing economic circumstances—and major typical assessment and taxation models. In the first half of 2012 in North Dakota, anger

over the property tax led to a “temper tantrum” reaction to simply abolish the tax. Figure 1 illustrates an examination of the North Dakota situation by one media outlet.

Scope and Definitions

The purpose of this article is not to dispute the arguments for or against the property tax as it exists. It is to inform the subject in general, so those who are analyzing elements of the property tax in response to particular allegations or perceptions gain perspective and are able to provide a more cogent and credible analysis. The article looks at common issues and themes that affect the property tax. Because of regional differences, property tax comparisons should be made very carefully.

Because there are many possible taxes on property, property tax in this article is defined as a recurrent tax based on the value (whether market value

or some other value) of the property against which the tax is levied. Hence, charges and fees that may be levied per house (i.e., sewer or water fees) or may be due on sale of property (i.e., transfer fees) are not included; the distinction between property taxes and these various other fees may appear to cloud the issues. The intent is to better focus the issues at hand on traditional property tax per se.

State and Regional Factors Affecting the Property Tax

Every state has provisions for property taxation to occur. The tax, however, is rarely and minimally used as a source of state revenue (see table 4). Rather, it is a mainstay and the domain of many local governments, such as schools, counties, cities, and special districts (e.g., fire protection, emergency services, road maintenance, and the like). In addition, there are multiple options regarding the type of property against

which the tax is levied. The determination of underlying taxable value is also subject to many considerations.

Hence, there is not one property tax in the United States. Because the property tax is predominantly a local tax (albeit authorized by the states and the District of Columbia, which is considered a local government) and because of local options regarding the tax, it is not even proper to suggest that there are 50 or 51 property tax systems. There are in fact many more. However, certain common features affect the buoyancy of the tax during difficult economic times and enable some comparisons to be drawn, if understood. These same factors heavily influence the ability to compare property taxes among regions.

Classification—Assessment at a Percentage of Market Value

It is common for states (more rarely localities) to authorize that taxable values (known as assessed values) of property be set as a percentage of market value, rather than at market value. Usually this is done to purposefully shift the property tax burden away from selected property types to others, regardless of underlying market value. For example, it is common for states to use percentages that favor residential property over commercial property. In such a system, the share of tax paid by residential property is lower than if all property were to be assessed at market value. However, arguably, this may make the system more resistant to economic downturns, such as the most recent one, which may have affected residential property to a greater extent than other property types, such as farmland or commercial property.

Frequency of Reappraisal or Revaluation

While the property tax is based on the premise that a taxable value for each property will be established annually, this taxable value may or may not be

Figure 1. Published opinion on move to abolish the property tax in North Dakota

Petitioners have filed a proposal with the secretary of state to repeal all property taxes in North Dakota and to replace these locally collected taxes with revenue collected at the state level. Residents will vote on the measure in the 2012 primary election.

Under the measure, the Legislature will be required to replace the lost revenue with state-collected taxes. Since the measure mandates replacement of the lost revenue, it is not designed to cut taxes but to shift them from the current payers to different payers.

As we discovered when we eliminated the personal property tax on farm equipment, store inventories and household goods, getting money back to the school districts, counties, cities and townships proved to be almost impossible—and personal property constituted only 15 percent of the total property tax at the time.

If the proposed measure intends that all local governments continue to receive the same amount of revenue from the state as they did from local property taxes, then the Legislature will have to develop a formula tailored to each political subdivision because local governments have a variety of local options. Consequently, every school district, county, city and township has a different mixture of programs and mill levies.

Under current law, counties have around 40 different levies they may or may not use. Among them are levies for such programs as roads, veterans' services, extension work, planning, advertising, emergency medical, weed control, senior citizens, job development, fairs and parks. Each county levies a different amount for each service within limits set by the Legislature.

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The same is true for cities. School districts may levy for special education, renting space, cooperative education, school buses, kindergarten, long-distance learning, school buildings and more. With each local government using property taxes in its own way, the Legislature will be required to come up with a payback plan that will fit each of the 2000 local governments using property taxes. Local governments could be given exactly what they are now raising. That may work for a year or two, but freezing the payback would not meet the changing needs of local governments. At the same time, local governments would be prevented from adopting any new options because they will have no access to revenue.

Source: <http://www.inforum.com/event/article/id/319024/group/Opinion/>.

based on current market value. Common alternatives include the following:

- Caps on value increases, which result in taxable values that lag market value when the market is increasing or decreasing rapidly; usually, taxable value cannot exceed market value.
- Cyclic reappraisal, in which some, but not all, property values are updated in a given year, with the remainder updated on a cyclic basis (e.g., every 6 years, every 4 years, and so on).
- Periodic scheduled adjustment, perhaps resulting in changes in taxable values every 2 years, for example.
- No scheduled adjustment or no uniform, statewide schedule; in this case, adjustment depends on either legal action or local governmental decisions to move from a base year.
- Base value as of a given year; this usually includes small allowable adjustments each year and, often, a provision for adjustment to full market value on sale.

Without understanding whether the revaluation systems are similar in two or more states or localities, it is impossible and misleading to make valid comparisons (especially of property tax rates) and to determine the effects of economic conditions that may, for

example, drive down home prices but have no immediate effect on taxable values. Table 1 demonstrates some of these options and shows the effect on taxable values under various hypothetical situations.

Table 1 accounts for some, but not all, variations of valuation systems. It accounts for *none* of the variations in the taxation side of the equation. It is the combination of the valuation limitations or conditions and the taxation limitations or conditions that ultimately determine how much tax revenue there will be and the shares and amounts to be paid by each property. In other words, just knowing what happens to taxable values is not enough to enable understanding of tax effects. Are tax rates frozen? Are property tax amounts frozen or subject to increase limitations, either by taxing district (as in many states) or by individual taxpayer (as in Nevada and California)? These questions must be explored to fully understand the property tax system and make valid comparisons among states.

Legislation, Rules, and Policies

One major area in which statutory provisions can influence comparison of property taxes among states is exemptions. There are some common themes—most states exempt charitable and religious organizations, for example. In addition, in many places, homeowners, agricultural and timber

enterprises, and regional economic development interests have received the benefit of partial exemptions, special constrained valuation methods, and other property tax incentives. These treatments may have the effect of lessening taxable value change in declining economies and must be taken into account when localities are being compared. In addition, exemptions and similar provisions may compensate for high tax rates.

An area of emerging legislative pressure is the treatment of personal property, usually defined as movable furniture, fixtures, machinery, and equipment, of businesses. In most states such property is taxable, but 10 states report broad exemptions for this type of property, six states report partial exemptions, and six states report local option exemptions (Dornfest et al. 2010). To complicate matters further, the definition used differs substantially among states (and is being redefined within states [Patterson 2012]). Thus, an item that is exempt as personal property in one state may not be in another, even though both states report *personal property* as being exempt.

Because of these and other similar issues involving exemptions and definitions, a *high* tax rate may be a meaningless comparative concept, especially for businesses seeking competitive advantages or homeowners considering moving from one state or region to another. For business, just simply understanding what is taxable (as well as what services may be provided) may be more important. For homeowners, special partial exemptions or other means of lowering taxable values of homes may be more critical.

Equalization

The term *equalization* refers to any process whereby a governmental oversight body alters values determined by the authority initially responsible for setting those values. The most common type of equalization occurs

Table 1. Effect of underlying valuation system on taxable value changes

System in Place	Year 1		Year 2		Year 3	
	Market Value	Taxable Value	Market Value	Taxable Value	Market Value	Taxable Value
Current market value	100,000	100,000	125,000	125,000	95,000	95,000
Taxable value frozen at lower of year 1 base value or current market value	100,000	100,000	125,000	100,000	95,000	95,000
Year 1 base value with no adjustment (i.e., frozen value)	100,000	100,000	125,000	100,000	95,000	100,000
Year 1 base value with 5 percent annual adjustment; taxable value cannot exceed current market value	100,000	100,000	125,000	105,000	95,000	95,000
Cyclic value adjustment—revaluation only in year 2	100,000	100,000	125,000	125,000	95,000	125,000

within local governments. For example, a board of review may examine data or respond to appeals and in turn adjust taxable values set by a local assessor. Often, local assessments (meaning taxable values) are subject to further review by state-level equalization agencies.

States follow several different models with respect to equalization of locally determined taxable values. Some states oversee valuations set by local assessors. They may change these values when they are outside certain standards. They may change values in determining state aid to education and other revenue-sharing programs; they may order reappraisal; or they may take no action. In the latter two cases, corrections for under-assessment or over-assessment may occur over a long period of time or not at all. Therefore, in making comparisons, it is important to know the degree and speed of implementation of equalization and, if there is limited equalization, the results of current ratio studies, which would show the current level of assessment, not just the statutory requirements.

It is equally important to understand the effect of equalization on taxes and on the distribution of state aid. Often, equalization serves to shore up funding for property *poor* areas (i.e., areas that would not be able to raise much property tax to support schools or other state-mandated services). Finally, when equalization alters taxable values, it is important to understand the underlying tax-levy-setting system to know whether this means significant changes in tax revenue or even in the amount of property tax that will need to be paid by individual taxpayers. Effects of such equalization often are not apparent, and results may be counter-intuitive if, for example, property tax levy caps and limits prevent taxing districts from taking advantage of large adjustments to taxable value.

Caps and Limits

In addition to caps on value changes discussed earlier, it is critical to understand limits that affect the amount of property tax that can be raised (levied). Although there are many nuances, there are two predominant systems in place in the United States: *budget- or levy-driven* and *rate-driven*.

In a budget- or levy-driven system, the dollar amount that can be raised (levied) in any year is fixed or subject to limited growth options (e.g., the dollar amount may be able to grow by 3 percent plus an allowance for new construction; see, for example, Idaho Code, §63-802). In this type of system, taxable value increases above the allowable budget increase result in lower levy rates (sometimes termed *rollbacks*), precluding taxing districts from realizing budget windfalls from value increases. At the same time, when taxable values decrease (as has been common in the current economic situation), tax rates float upward to produce the same property tax dollars. This system effectively prevents (or minimizes, in the case in which there are rate limits above which taxing district rates cannot go) loss of revenue for property-tax-funded services.

In a rate-driven system, the dollar amount that can be raised (levied) in any year is determined after taxable values are set by multiplying the statutory or given rate by the underlying taxable value in a taxing district. If taxable values rise, more property tax revenue is derived. Conversely, if tax-

able values fall, there is less revenue for taxing districts.

Those making property tax comparisons often assume that the rate-driven system is in effect everywhere. Hence, they draw the logical, but often incorrect, conclusion that falling property values must be leading to lower local government revenue. To understand the validity of this assertion, it is necessary to understand which of the two main underlying systems is being used and what the restrictions are in the regional systems being compared.

Table 2 compares rate-driven and levy- (budget-) driven taxation systems in terms of how much tax is collected overall and how much is paid by individuals given many changes in taxable value (modeled after Table 6-1 in Almy et al. 2008, 173).

The initial year's tax rate in this example is 1.25 percent. In the rate-based column, however, the taxing authority merely leaves its tax rate the same between the two years, and given growth in taxable value, the system generates additional property tax revenue.

While table 2 illustrates the effect of rate-based or levy-based taxation systems given the classic case of taxable values that generally increase over time, it does not show what happens given declining property values, which have been experienced in many areas in recent years. Understanding the underlying taxation system is as critical in declining markets, because the results may be counter-intuitive to the

Table 2. Comparison of rate- versus levy- (budget-) driven taxation systems when taxable property values are increasing

Parcel	Taxable Value		Property Tax (\$)			Net Difference (\$) (Rate-Based versus Budget-Based)
	2011	2012	2011	2012		
				Rate-Based	Levy- (Budget-) Based	
A	100,000	200,000	1,250	2,500	2,222	+278
B	100,000	100,000	1,250	1,250	1,111	+139
C	100,000	100,000	1,250	1,250	1,111	+139
D	100,000	50,000	1,250	625	556	+9
Total	400,000	450,000	5,000	5,625	5,000	+625

common expectation that property tax revenue will be lower. The two prevalent systems are compared in table 3 for declining taxable values. In table 3, in the budget-based system, the levy rate floats upward from 1.25 percent to about 1.52 percent. This compensates for decreasing taxable values and has the effect of protecting the property tax revenue stream for the taxing district.

There tends to be a broad misunderstanding that all or even most property tax systems are based on fixed rates and, therefore, taxes react like the rate-based example in table 3; that is, overall amounts decrease when underlying overall taxable values decrease. Often, underlying taxation systems are hybrids and do not reflect either budget or rate bases entirely. Nevertheless, this significant aspect of property tax systems must be understood for comparisons or overall statements or predictions about property tax to be meaningful.

Property Taxes as Part of Governmental Finances

Both state and local government finances include revenue from various sources. The United States Census Bureau compiles information on these sources for each state and nationally. Figure 2 is an example of a compilation for fiscal year 2009.

Table 4 summarizes some key features of this revenue picture. Note that the major sources of state general revenue contribute only 61.9 percent of total state general revenue and 60.5 percent of local general revenue. This is because general revenue includes intergovernmental revenue sharing (see highlighted row in figure 2), mostly from the Federal Government with respect to states and from states with respect to local government. Figure 2 shows that revenue sharing from the Federal Government constitutes 31.8 percent of state government general revenue. Similarly, figure 2 shows that revenue sharing from federal and

state government to local government constitutes 37.7 percent of local government general revenue.

Table 4 demonstrates the emphasis on property tax at the local level. The proportion of local government

funding provided by this source has remained relatively stable for some time, actually increasing slightly since 2005, when it accounted for 72 percent of local government tax revenue. For comparison, in 1980, property

Table 3. Comparison of rate- versus levy- (budget-) driven taxation systems when taxable property values are declining

Parcel	Taxable Value		Property Tax (\$)			Net Difference (\$) (Rate-Based versus Budget-Based)
	2011	2012	2011	2012		
				Rate-Based	Levy- (Budget-) Based	
A	100,000	80,000	1,250	1,000	1,212	-212
B	100,000	100,000	1,250	1,250	1,515	-265
C	100,000	100,000	1,250	1,250	1,515	-265
D	100,000	50,000	1,250	625	758	-133
Total	400,000	330,000	5,000	4,125	5,000	-875

Figure 2. Sources and amounts of state and local government revenue

(Dollar amounts are in thousands. Coefficients of variation (CV) are expressed as percentages. For meaning of abbreviations and symbols, see note below table.)
 Source: U.S. Census Bureau, 2009 Annual Surveys of State and Local Government Finances. Data users who create their own estimates using data from this report should cite the U.S. Census Bureau as the source of the original data only. The data in this table are based on information from public records and contain no confidential data. The state government data in this table are from a survey of all state governments and are not subject to sampling error. The 2009 local government data in this table are from a sample of local governments, and as such, are subject to sampling variability. Additional information on sampling and nonsampling error, response rates, and definitions may be found at http://www2.census.gov/govs/state/09_methodology.pdf and http://www2.census.gov/govs/estimate/2009_local_finance_methodology.pdf

Description	United States Total				
	State & local government amount ¹	State & local government CV	State government amount	Local government amount ¹	Local government CV
	1	2	3	4	5
Revenue¹	2,066,665,708	0.09	1,123,226,058	1,433,817,792	0.14
General revenue ¹	2,413,384,189	0.07	1,495,730,319	1,408,032,013	0.13
Intergovernmental revenue ¹	536,760,320	0.10	495,623,675	531,514,788	0.16
From Federal Government	536,760,320	0.10	475,952,532	60,807,788	0.89
From State government ¹	(1)	(X)	-	470,706,999	0.14
From local governments ¹	(1)	(X)	19,671,143	(1)	(X)
General revenue from own sources	1,876,623,869	0.09	1,000,106,644	876,517,225	0.19
Taxes	1,271,355,992	0.10	715,496,219	555,859,773	0.24
Property	424,014,170	0.28	12,964,188	411,049,982	0.29
Sales and gross receipts	433,556,219	0.12	344,567,991	88,988,024	0.57
General sales	291,045,219	0.16	228,728,864	62,316,355	0.73
Selective sales	142,510,796	0.16	115,839,127	26,671,669	0.87
Motor fuel	37,815,730	0.11	36,471,286	1,344,444	3.02
Alcoholic beverage	5,865,179	0.45	5,347,705	517,474	5.08
Tobacco products	17,157,014	0.02	16,889,547	467,467	0.55
Public utilities	28,376,118	0.61	14,898,003	13,478,115	1.29
Other selective sales	53,296,755	0.27	42,432,586	10,864,169	1.32
Individual income	270,517,726	0.06	245,880,786	24,636,940	0.64
Corporate income	45,979,954	0.02	39,277,558	6,702,396	0.13
Motor vehicle license	21,296,295	0.12	19,626,624	1,669,671	1.51
Other taxes	75,991,833	0.30	53,179,072	22,812,761	0.99
Charges and miscellaneous general revenue	605,267,877	0.16	284,610,425	320,657,452	0.31
Current charges	388,766,090	0.24	161,238,746	227,527,344	0.41

Source: United States Census Bureau. *State and Local Government Finances by Level of Government and by State: 2008–2009*. <http://www.census.gov/govs/estimate/> (accessed Feb. 1, 2012).

Table 4. Proportions of state and local revenue contributed by various taxes and charges (fees) in FY 2009

Revenue Source	General Revenue (%)		Tax Revenue (%)	
	State Government	Local Government	State Government	Local Government
Property tax	0.9	29.2	1.8	74.0
General sales tax	15.3	4.4	32.0	11.2
Selective sales taxes	7.7	1.9	16.2	4.8
Individual income tax	16.4	1.7	34.4	4.4
Corporate income tax	2.6	0.5	5.5	1.2
Charges and misc. revenue	19.0	22.8	NA ^a	NA
Total	61.9	60.5	89.9	95.6

^a NA = data not available.

tax accounted for 76 percent of local government tax revenue. Prior to that time, it accounted for a higher percentage; however, the decrease in this proportion was due to increased state payments to local governments, not to increased use of other taxes (Fisher 1996, 203–204).

Figure 3 shows the sources of state and local revenue in fiscal year (FY) 1992 for recent comparison. Table 5 shows the proportional shares of local government revenue derived from each major source in 1992 and 2009. In addition, table 5 includes FY 1977 revenue shares, an important comparison because that year predated any of the major property tax revolts, led by California's Proposition 13 in 1978. It is apparent that, for local governments in the United States, both fees and taxes,

including property taxes, have tended to be level during the most recent 17-year period shown in table 5.

Over the same period, the proportion of local government funding contributed by states in the form of revenue sharing has increased. Over a much longer time span, there has been a decrease in reliance on the property tax for local government funding. This is apparent from the FY 1977 data in the table. This decline is more dramatic over an even longer period. In 1962, 48 percent of local government general revenue and 88 percent of local government tax revenue was derived from property taxes (Almy et al. 2008, 13). Nonetheless, despite political pressure to lower property taxes and local movements in that direction, there has been no

measurable national trend along these lines in recent years. While this may be surprising, it may also reflect the importance of the property tax and the nearly insurmountable challenges of replacing this revenue source.

Two other trends are notable in table 5. First, while relatively stable from 1992 to 2009, charges and fees increased significantly from 1977 to 1992—the share represented grew by 50 percent. Undoubtedly, this reflects the pressure to decrease reliance on the property tax over that period. Second, the proportion of local government revenue derived from the Federal Government declined from 9.3 percent in FY 1977 to 3.5 percent in 1992, before rebounding slightly to 4.3 percent in 2009. Arguably, therefore, some of the needs fulfilled by increased charges and fees may have been funded with federal funds previously.

In Lieu of Taxes

Local government funding is always multifaceted, deriving revenue predominantly from some combination of property tax, other taxes, fees and charges, and intergovernmental revenue sharing. To understand the impact of lower property taxes, it is critical to understand the availability and interrelationship of all the current or potential revenue sources. For example, the inability to raise or sustain property taxes for parks may result in park closures or increased fees for use of park facilities.

Intergovernmental revenue sharing is a key fiscal component for many local governments, which may derive significant shares of revenue from the state or the Federal Government. Some of this revenue may be tied to mandates to lower property tax by some amount or percentage of the revenue received. This is especially true with regard to state-provided revenue sharing, which often has

Figure 3. Sources of state and local revenue, FY 1992

U.S. Census Bureau			
State and Local Government Finances by Level of Government and State: 1991-92 (Thousand dollars. Detail may not add to total because of rounding)			
Geographic area and item	UNITED STATES		
	State and local governments ¹	State government	Local governments ¹
	1	2	3
Population (July 1, 1992, in thousands)	255,082	254,493	255,082
Personal Income (Calendar year 1991, in millions)	5,376,622	5,359,089	5,376,622
Revenue¹	1,189,987,099	743,521,591	655,215,792
General revenue ¹	979,136,792	608,804,311	579,082,765
Intergovernmental revenue ¹	179,174,330	169,928,166	217,998,448
From Federal Government	179,174,330	159,067,541	20,106,789
From State government	0	0	197,889,659
From local governments ¹	0	10,860,625	0
General revenue from own sources	799,962,462	438,876,145	361,086,317
Taxes	559,859,016	331,179,823	228,679,193
Property	180,336,841	7,363,812	172,973,029
Sales and gross receipts	197,731,143	164,135,284	33,595,859
General	131,979,152	108,712,128	23,267,024
Selective	65,751,991	55,423,156	10,328,835
Motor fuel	22,958,092	22,252,877	705,215
Alcoholic beverage	3,882,309	3,590,510	291,799
Tobacco products	6,311,867	6,118,679	193,188
Public utilities	13,475,193	7,764,969	5,710,224
Other	19,124,530	15,696,121	3,428,409
Individual income	115,637,837	104,894,892	10,642,945
Corporate income	23,880,252	21,851,236	2,029,016
Motor vehicle license	11,496,534	10,652,964	843,570
Other taxes	30,776,409	22,181,635	8,594,774
Charges and miscellaneous general revenue	240,103,448	107,696,322	132,407,124
Current charges	138,304,683	52,941,024	85,363,659

Source: United States Census Bureau, Governments Division, 2003. "State and Local Government Finances by Level of government and State: 1991–92." <http://www.census.gov/govs/estimate/92sl00us.html> (accessed April 17, 2012).

Table 5. Proportion of local government revenue contributed by various taxes and charges (fees), FY 1977, 1992, and 2009

Revenue Source	General Revenue (%)			Tax Revenue (%)		
	FY 1977	FY 1992	FY 2009	FY 1977	FY 1992	FY 2009
Property tax	33.7	29.9	29.2	80.6	75.6	74.0
General sales tax	3.0	4.0	4.4	7.2	10.2	11.2
Selective sales taxes	1.6	1.8	1.9	3.8	4.5	4.8
Individual income tax	2.1 ^a	1.8	1.7	5.0	4.7	4.4
Corporate income tax	^b	0.4	0.5	^b	0.9	1.2
Charges and miscellaneous revenue	15.2	22.9	22.8	NA ^c	NA	NA
State revenue sharing	33.7	34.2	37.7	NA	NA	NA
Federal revenue sharing	9.3	3.5	4.3	NA	NA	NA

^a In FY 1977, corporate income tax was not separately reported, but was included in the figure reported for individual income tax.

^b Included with individual income tax.

^c NA = data not available.

Source: United States Department of Commerce, Bureau of the Census. *Governmental Finances in 1976-77*. Table 24. "Local Government Finances, by State and Type of Government: 1976-77." November 1978.

been initiated to provide replacement money or to prevent tax shifting with respect to a new exemption. Although such payments may be planned to continue indefinitely, intergovernmental revenue shares may be reduced, especially when higher levels of government have fiscal crises. Currently, for example, there is no congressional reauthorization for certain federal monies used to support schools, roads, and highways in areas where timber is harvested from federal lands (Craig/Wyden funds). These funds are scheduled to expire in 2012, and the disappearance of these funds is likely to place more pressure on property taxes or fees, depending on the ability of localities to raise either.

At the state level, Idaho has been debating whether to exempt personal property from property taxes. Replacement money would amount to 10 percent of the total property taxes and may not be fully responsive to future growth in personal property (machinery and equipment). Such a large amount of funding could be in jeopardy when future economic downturns occur. This in turn could create more pressure for property tax increases. Again, the interrelation of these alternative funding sources must be understood to appreciate differences in property tax levies.

On the flip side, some entities otherwise exempt from property taxes may pay in lieu of amounts to help defray the cost of local government services related to their existence. For example, colleges sometimes pay local governments to prevent otherwise high property tax rates and to be viewed as full participants in local communities. The availability of this type of funding serves to lessen pressure on property taxes.

State Subsidies

One of the most significant sources of local government general revenue is money received from state governments. In FY 2009 (United States Census Bureau, Governments Division, 2003. "State and Local Government Finances by Level of government and State: 1991-92." <http://www.census.gov/govs/estimate/92sl00us.html> (accessed April 17, 2012), this amount was 33.4 percent of all local government general revenue. As indicated previously, state subsidies can be in lieu of property taxes, or they can be in the form of grants and matching funds for schools, highways, indigent needs, and other programs. The extent of these funds can affect the need for property taxes.

Aside from state subsidies to local governments, states may provide direct or indirect credits related to

property taxes. The purpose of these credits may be to promote economic development or to sustain certain property uses (e.g., circuit breaker tax credits to reduce the impact of property taxes on low-income homeowners). Such subsidies take the pressure off property tax with respect to the affected properties. This in turn must be taken into account when tax burdens in different areas are compared.

Are Property Taxes High?

To understand this important and often explored aspect of property (and other) taxes, it is crucial to parse the question into areas of tax incidence and tax burden. The key difference is that *tax incidence* looks at different sectors of the economy and analyzes how the tax burden is distributed to each sector. *Tax burden*, on the other hand, takes income or population differences into account and can differentiate between tax types (i.e., property, income, and sales), but does not distinguish between different types of taxpayers.

So, for example, a tax burden study may show that the average per-capita property tax in the United States was \$1,381 in FY 2009 and that the per-capita property tax in Idaho was \$812 that year (Dornfest 2012a). Does this mean that the per-capita property tax burden in Idaho is comparatively low? Yes. Does it mean that homeowners in Idaho pay less property tax than homeowners in most other places in the United States? Not necessarily. Per-capita tax often is misconstrued to mean the tax paid by individuals or homeowners. In fact, its straightforward definition is the total property tax collected divided by the total population of the state or the country. The total tax includes taxes paid by farmland, timberland, industrial, and commercial property as well as homes. Can conclusions be drawn about whether rich or poor property owners pay higher or lower taxes in one state than in another? Yes, but only if

incidence and burden are included in the analysis.

In an attempt to bridge this gap, the government of the District of Columbia analyzes property, sales, income, and motor vehicle taxes paid by homeowners living in families of three people and earning varying amounts of income (Government of the District of Columbia 2011, <http://cfo.dc.gov/node/296712>, accessed November 20, 2012). Although this analysis provides another perspective and certainly makes comparisons between places more accessible, its conclusions are dependent on underlying assumptions about family economic life. It also analyzes only the largest city in each state, so comparisons may not reflect other areas.

Tax burden studies often show places with high property taxes when, in fact, the taxes are levied in an atypical way or the taxes tend to be paid largely by a narrow sector of the economy.

Other studies attempt to isolate taxes paid by the lowest or highest income taxpayers or groups of taxpayers. Each study is valid to the extent the underlying assumptions are stated and reviewed for pertinence with respect to the intended use of the analysis for comparison.

One last cautionary note. Tax burden studies often show places with high property taxes when, in fact, the taxes are levied in an atypical way or the taxes tend to be paid largely by a narrow sector of the economy. For example, some states levy property tax on vehicles, while others do not but may have higher registration fees. Unless all vehicle-related taxes and fees are identified, either the tax or the registration fee may appear distorted in comparison to other localities.

As another common example, states with economies largely dependent on natural resources, such as oil and gas, often appear to have high property taxes. Wyoming is such a state, and its per-capita property tax burden was 68 percent higher than the United States average in FY 2009. Alaska's per-capita property tax burden was 24 percent higher than the United States average for the same year. Yet, do either of these states have high *residential* property taxes? Both states have significant portions of their property tax paid by their resource industries, so any conclusion about residential property taxes based on these statistics is inappropriate and misleading.

Strengths and Weaknesses of Taxes Used by Local Governments

Property tax is often criticized on the basis of several features or perceptions, including

- Large lump-sum payments
- Ability to pay less related to income
- Effect on unrealized capital gains
- Complex administration and calculation.

States and localities have enacted various strategies to reduce these negative attributes and perceptions. Several states permit installment payments to avoid the lump-sum problem. At least 30 states have circuit breaker programs to help low-income homeowners (and sometimes renters) pay property taxes. Appeals systems and public relations programs promote transparency. Local officials, who usually are responsible for administering the property tax, tend to be more accessible than state officials.

To the extent non-property taxes are available for local government use, there may be less pressure on the property tax and rates may be low. This is often true in tourist areas, where sales taxes and various fees may provide adequate substitutes, and in

areas with abundant natural resources, such as oil and gas, with associated fees and severance taxes.

With these exceptions, other taxes generally are less suitable for local government use. In particular, sales and income taxes require extensive administrative structures, which do not exist for most local units of government. Property tax collection and administration tends to be consolidated at the county or town level, with special-purpose districts, such as fire and flood control districts, receiving property tax revenue but not otherwise administering the tax. Sales and income taxes rarely are used by special-purpose districts. In addition, because the property tax tends to be more stable despite economic up and down swings, it is more suitable to sustaining specialized local services, the need for which presumably remains relatively unchanged regardless of economic trends.

Local Factors Affecting the Property Tax

Many factors can affect the property tax, such that apparently similar cities, counties, or other local entities have very different reliance on property tax and very different property tax rates. Before it can be concluded that one jurisdiction outspends another, these factors need to be isolated. Spending is important, but, in addition, at the local level, property taxes and tax rates may be high or low depending on the following factors:

- The available tax base
 - The extent of exempt properties
 - Availability of in lieu of tax payments by exempt entities
 - Valuation base in terms of current market value versus out-of-date base or other value systems

- Available alternatives for funding services
 - State or federal intergovernmental aid
 - Local non-property taxes (i.e., local option sales or income taxes)
 - Ability of local government to establish and increase fees for services
- The extent of services provided by local government
 - Mandates from the state and the Federal Government (i.e., indigent health care, sewage treatment, emissions testing)
 - Local demand for services such as libraries, fire protection, recreation, specialized school programs (e.g., language, remedial classes)
- The extent of unfunded pension liability and other forms of long-term debt
- The existence of rate caps or constraints that may preclude property tax increases.

Local Budget Funding Requirements

Local units of government may be mandated to provide services that vary within different states or in specific locations within a state. Such services may be diverse, with one local government needing more funding for courts and others needing more funding for indigent care and catastrophic health care or environmental remediation.

Local government funding needs and property tax requirements are also influenced by the structure of government within a state. For example, many western states supplement state funding of road maintenance with local funding raised by means of property tax. This model generally is not used in eastern states, so this particular pressure on local property taxes is less likely to exist.

Funding requirements may also be influenced by local demand, with certain communities wanting more recreational options, such as bike paths, while others want only bare-bones governmental involvement with few discretionary amenities. The bottom line may be, as some public finance experts contend, that based on a combination of variation in demand for local services and the need for stable revenue with which to provide for these services, for American cities, towns, and counties, “...there are no viable alternatives to taxing property, at least none that can ensure fiscal and political autonomy” (Brunori 2003, 2).

A key emerging area of concern is unfunded pension liability, which grew substantially in many areas during the recent economic downturn. In many instances, this liability has increased the amount of long-term debt that must eventually be paid from property taxes.

School Funding

School funding tends to be an example of a shared expense, with both states and local governments responsible for raising money. In FY 2007, for example, half of all property taxes were used to finance elementary and secondary public education in the United States and 29 percent of all school funding came from property tax (Kenyon 2007, 4). However, in the last several years, states such as Michigan, Idaho, and South Carolina have reduced reliance on local property taxes for such school funding, substituting state funds as replacement.

In at least one of these states, Idaho, state funding shortfalls subsequently have resulted in pressure to pass local property tax *supplemental* levies, and what began as reduced property taxes now appears as increased property taxes in self-selected school districts (Dornfest 2012b). It is therefore increasingly important for those

comparing property taxes among states and localities to understand the nature and availability of both state funds and property taxes for school funding. In addition, legislation changes the playing field and the rules, so past practice and law may not indicate current patterns.

Funding requirements may also be influenced by local demand, with certain communities wanting more recreational options, such as bike paths, while others want only bare bones governmental involvement with few discretionary amenities.

It is important to determine what is meant by *school funding* and to distinguish between various elements and uses of that funding. So, in Idaho, for example, it is equally correct to report that general school funding is no longer provided by property tax for most school districts; yet, in 2011, 29 percent of all property tax in Idaho was raised by direct school district levies (Dornfest 2011). Is there a disconnect? Yes, but it’s all in the meaning of words such as *general school funding*, which does not include levies for new buildings, repairs, emergencies, liability insurance premiums, and other functions for which property tax support is still permitted. These nuances of property tax systems are not simply semantic and must be understood for meaningful reporting on school funding issues.

Special Taxing Districts or Special Service Areas

The 2007 Census of Governments (United States Census Bureau 2011) reported 89,476 local governments, including school districts, in the United States. Of these, 29,044 were considered general purpose, such as

counties, municipalities, and towns or townships, each of which performs multiple functions and some of which may be supported with property taxes. The remaining 50,432 local governments are considered special purpose, usually meaning that they perform one primary function, such as providing fire protection. To help understand the diversity in taxing districts, table 6 provides examples of the types and numbers of general and special-purpose taxing districts in Idaho.

Sometimes local governments have authority to raise revenue through property taxes but instead receive revenue from general-purpose governments that are authorized to levy

Table 6. Examples of general and special-purpose taxing districts based on use in Idaho in 2011

District Type	2011 Idaho Taxing Districts	
	Number of Districts	Districts Levying
Ambulance	25	25
Auditorium	3	2
Cemetery	180	178
Cities	201	191
Community Colleges	3	3
Counties	44	44
Fire	157	157
Flood Control	14	10
Herd	1	0
Highway-County Road & Bridge	98	74
Hospital	17	16
Infrastructure	1	1
Library	56	55
Abatement	23	22
Pest Control	5	5
Port	1	1
Recreation	34	29
Regional Airport	0	0
School	115	114
Sewer	36	11
Sewer & Water	53	14
Water	26	5
Watershed Improvement	9	1
Total	1,104	958

property tax for that purpose, or local governments have no property tax authority and instead rely on fees, grants, and other revenue sources. This disparity leads to comparison difficulties.

For example, as shown in table 6, in Idaho sewer and water districts all have authority to levy property taxes, but few do so. A taxpayer located in a sewer or water district that does levy property tax may appear to be paying more, but may in fact be paying less overall than another taxpayer with property in a sewer or water district that does not levy property tax but has higher fees.

In addition, general-purpose governments do not all provide the same level of services. Large cities, for example, commonly provide fire protection services as part of their general fund, using their property tax authority. Small cities may not be able to maintain the infrastructure necessary to pay for fire protection services, so fire protection districts may charge property tax to property owners. So, in the small city, it may appear that an additional property tax is being paid; in reality, the tax is simply more transparent, instead of being buried in the large city's general fund. Merely comparing property tax between the two taxpayers would lead to a misleading and wrong conclusion about the costs of supporting government in the two areas.

Tax Increment Financing Districts

As of 2009, 26 states report provisions for tax increment financing (TIF) (Dornfest et al. 2010). Under typical TIF systems, some or all property taxes raised within predesignated areas are diverted from taxing districts to defray costs for infrastructure and other developments in these areas. Depending on the underlying budget and levy system and on the potential for development of the area without the availability of TIF, this could mean

lower property tax revenues for taxing districts that overlap such a designated area. In some cases, however, taxing district revenues are protected through higher levy rates. In this instance, taxpayers may be required to pay more, making up for amounts lost to the TIF districts. Even then, however, blanket statements about such effects should not be made. For example, if the development would not have occurred without the advantages of TIF, then the tax rate and tax paid would be unaffected and the program would be neutral to all taxpayers. Without an understanding of the nuances, comparisons between TIF programs and their effect on taxpayers and taxing districts are dubious at best.

Other Sources of Income (Revenue)

As indicated earlier, local governments have many potential sources of income or revenue. These are delineated in figure 2 and table 4 and, depending on underlying state statutory constraints, may be more or less available in different states. To the extent alternatives are available and there is the necessary political will to use them, there may be less pressure on the property tax.

Staffing and Infrastructure to Maintain Taxing System

Some fundamentals are implicit in managing a property tax system and ensuring that all taxable property is included and that appropriate billing and collection laws and processes are in place. Staffing must be sufficient to identify and list new construction and new land developments that have become taxable or have changed in use. This requires review of building permits and inspection of developing sites and accurate maps and records. For personal property that may be self-reported, various follow-up and audit-type procedures may be necessary to prevent under-reporting. Without

sufficient staffing and process control, gaps will occur and may lead to higher tax rates or lower tax collections.

Public Control (Referendums versus Legislation, Administrative Rules, Appeals Court Decisions)

Not all tax policy is implemented as part of the legislative process. Often public referenda begin as grass-roots movements and dramatically restructure the property tax system and environment. This certainly was the effect of Proposition 13 in California, which, in the late 1970s, amended the California constitution to restrict both taxable value increases and property tax rates. Aside from the obvious effects, to better understand the evolution, or lack thereof, of property taxes in response to similar public pressure, it is important to understand whether state constitutions are subject to direct amendment through referenda or only to indirect amendment by election following legislative enactment of a proposed constitutional change. In Idaho and similar states, direct amendment of the constitution through referenda is not permitted, so sudden major changes in the underlying property tax system are less likely, because legislative changes must pass constitutional muster.

States often maintain administrative oversight and some degree of control with regard to the property tax system and local implementation of statutory provisions. In such cases, state property tax agencies are authorized to develop and promulgate administrative rules to clarify statutory provisions and promote consistent assessment administration practices among local assessing officials. Although such administrative rules have some *extra-legal* components, such as development with limited legislative involvement, properly promulgated rules generally have the force of law, so they should

be thought of as elements of the law developed by an alternative process, rather than by typical legislation. In actuality, depending on the structure of the administrative agency and constraints on the rule-making process imposed by the legislative branch, public input to the process may be more or less than during the ordinary legislative process.

Although actions by appeals bodies and lower courts that are not further appealed may not set precedents, they can result in major tax shifts or losses of property tax revenue when large property owners win significant valuation or exemption claims.

Court decisions, especially state supreme court decisions, can alter valuation and tax policy interpretations. However, there may be effects from lower court interpretations and, on occasion, federal court interpretations. Although actions by appeals bodies and lower courts that are not further appealed may not set precedents, they can result in major tax shifts or losses of property tax revenue when large property owners win significant valuation reduction or exemption claims. Often such cases take a long time to be resolved and may thereby result in tax refunds. Sometimes, taxing districts are granted authority to levy additional property taxes to make up for such refunds (see, e.g., Idaho Code §63-1305). Although such additional levies may be short-lived, they may distort comparisons for a period of time and misleadingly lead to unwarranted conclusions about the level of taxation or tax rates in a given area.

Physical Factors Affecting the Property Tax

Properties may pay more or less property taxes because of the taxing districts that provide the services and their revenue structures. Alternatively, the property tax is a tax based on wealth as measured by property value, whether it is current market value or something else. For valid comparisons, therefore, the underlying value of the property and the factors that influence that value also have to be understood. Some of the common factors affecting the value of real property in general and residential property in particular are as follows:

- Physical condition (damage, deterioration) of specific properties and or neighborhoods
- Construction quality
- Lot size, shape, and topography
- Size of improvements
- Heterogeneity of neighborhoods
- Local housing market supply and demand
- View, street appeal
- Access
- Availability of services, especially high-quality schools
- Nearby advantageous or detrimental influences
- Economic opportunity (employment).

Conclusion

Tax comparisons among areas require an understanding of social, political, economic, and geographic factors, including those that affect intergovernmental revenue sharing and the needs and demands of citizenry for local government services. The overarching system in place must also be understood, so that the effects of providing exemptions, credits, or tax limits are clear in terms of tax shifting

or revenue loss potential. The degree of local autonomy must also be understood; it differs widely among states—some states give local governments significant home rule authority and others require local governments to have specific authorization to levy or raise taxes or provide services.

The message for those analyzing and comparing levels of taxation among areas is this: it is not sufficient merely to look for areas of similar size or general economic conditions. It is, however, necessary to investigate apparent differences, thoroughly trying to match high effective tax rates with the quantity and quality of services demanded and provided by local governments. Both the tax incidence (i.e., which sectors of the economy pay more or less) and the tax burden (i.e., how high or low the tax is) must be understood to completely recognize positive and negative effects and comprehend the implications of the comparison being conducted.

Finally, the assessment system responsible for developing the taxable values underlying the property tax system must be understood. During times of rapid increases or decreases in value, this aspect of the system becomes especially important to avoid misconstruing effects that may be counter-intuitive. Caps on assessed value changes and irregular reassessment cycles may preclude decreased taxable values despite economic indicators to the contrary. Similarly, budget-based systems that permit tax rates to increase may preclude loss of revenue for taxing authorities, despite lower assessed values.

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Definitions

Board of Review (Equalization)—(1) A public body (other than a court) having jurisdiction over one or more assessment districts, charged with the duty of examining the assessment roll or rolls, and empowered, on appeal or on its own initiative, to revise individual assessments (preferred). (2) Broadly, any such board or any board of appeals or board of equalization.

Equalization—Alteration by a government oversight body of property values previously determined for assessment purposes by the authority initially responsible for setting those values.

Payment in Lieu of Taxes (PILOT or PILT)—A program in which the Federal Government makes payments to state governments for nontaxed land owned by the Federal Government. Some states make payments in lieu of taxes to local governments where state-owned property is tax exempt.

Personal Property—Personal Property that has a substantial physical presence beyond merely representational. It differs from real property in its capacity to be relocated. Common examples of tangible personal property are automobiles, boats, and jewelry.

Real Property—Consists of the interests, benefits, and rights inherent in the ownership of land plus anything permanently attached to the land or legally defined as immovable; the bundle of rights with which ownership of real estate is endowed. To the extent that “real estate” commonly includes land and any permanent

improvements, the two terms can be understood to have the same meaning. Also called “realty.”

Tax Burden—Economic costs or losses resulting from the imposition of a tax. Burden can be determined only by detailed economic analysis of all economic changes resulting from the tax. In popular usage, the term often refers to the initial incidence rather than to ultimate economic costs.

Tax Incidence—The distribution of a tax on natural persons who bear the tax after the completion of the process of tax shifting, to be distinguished in particular from the distribution of the tax on the persons, natural or legal, who pay it in the first instance.

Tax Increment Financing (TIF)—The idea that property taxes, or other revenue, resulting from the increase in a tax base (e.g., property values or retail sales) in a specific area can be used to repay the costs of investment in that area. Funds may be invested in various programs, such as public infrastructure improvements or land write-down subsidies to private investors. Also known as enterprise zone.

Tax Rate—(1) The amount of tax stated in terms of a unit of the tax base, for example, 30 mills per dollar, 2 percent, 2 cents per gallon. (2) For the property tax, the percentage of assessed value at which each property is taxed in a given district. Distinguish between effective tax rate and nominal tax rate.

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