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PROPERTY TAX ISSUES IN NEBRASKA

By

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Overview

Property taxes are the primary source of revenue for local units of government in Nebraska. In 1988, general property taxes levied for school districts, counties, municipalities and a variety of special districts totaled $1.167 billion or about $730 per capita.

Property that is taxed falls into one of two broad categories. Real property is land, or improvements to land, such as residences and commercial buildings. Personal property includes such items as motor vehicles, business equipment, boats and airplanes.

Tax liability is a function of both the value of property owned and a tax levy.

Property values for tax purposes historically have ranged from 20 to 100 percent of actual market value. As a result of numerous court decisions and actions by the Nebraska Legislature, the State Board of Equalization and Assessment (hereafter, State Board) has required that all classes of property be valued at no less than 90 percent of market value for 1989.

The tax levy is expressed as dollars and cents per hundred dollars of assessed value. For example, if the levy is $2.50, property owners pay $2.50 per hundred dollars of assessed value. In 1988, county-average tax rates ranged from a low of $1.66 in Banner County to a high of $3.14 in Dawes County. The statewide average was $2.61. (The 1989 statewide average rate may decline because of higher valuations, especially on agricultural land.)

Assessment, levy-setting, and collection of most property taxes in Nebraska are done by local government officials, specifically County Assessors, County Clerks, and County Treasurers. However, some types of property, such as telephone companies and pipelines, are centrally assessed by the Nebraska Department of Revenue. Taxes on centrally-assessed property also may be collected at the state level. Various formulas are then used to return tax revenues to individual counties.

By almost any standard, property taxes are high in Nebraska. In 1987, Nebraska property taxes per capita were 28 percent higher than the U.S. average of $498. This was thirteenth highest among the 50 states.
Also in 1987, 4.62 percent of Nebraskans' personal income went for property taxes, compared to 3.43 percent nationally. Nebraska ranked eighth using this comparison.

With respect to property taxes for individual classes of property, two comparisons may be particularly enlightening. The 1988 comprehensive Syracuse University study of Nebraska's tax system found that in 1985 only New York and New Jersey had higher effective property tax rates on single family homes. (The effective property tax rate is the ratio of taxes paid to current market value.) And in 1987, the U.S.D.A.'s Economic Research Service found Nebraska's average tax levy of $2.04 per $100 of market value on farm real estate more than twice as high as the national average of $.86 per $100 of market value.

High property tax rates are of concern not only to individual taxpayers, but many local units of government in Nebraska. Frequently, the needs of the tax district (jurisdiction) and its ability to generate revenues from property taxes are widely divergent. The Syracuse University study sums it up this way: "Jurisdictions with low incomes or low concentrations of commercial and industrial property (and hence a low ability to export their property tax burden to nonresidents) are in poor fiscal condition, all else equal, because they cannot raise an average amount of revenue without imposing a much higher than average property tax burden on their residents." In a word, many Nebraskans believe our property tax system is unfair.

Beyond these general concerns, a number of specific property tax issues have emerged in recent months:

1. Is it desirable to extend general property tax relief enacted in 1989 beyond its scheduled expiration date of July 15, 1990?

2. What is the most appropriate long-term response to the current personal property tax crisis in Nebraska that threatens to reduce the property tax base even further?

3. Should the method of financing public elementary and secondary education be changed, based on recommendations of the School Finance Review Commission?

4. Is it desirable to place agricultural land in a separate, non-uniform class of property for purposes of levying a tax?

Each of these issues is likely to be discussed in public forums and the Nebraska Legislature in the months ahead. In addition, more decisions relative to property taxes may be forthcoming from the state's court system. The purpose here is to give perspective to each of these issues.

General Property Tax Relief

In May, 1989, the Legislature passed and the Governor approved LB 84, which provided general property tax relief amounting to $98.1 million for 1989. For many taxpayers, this will result in local property tax bills that will be 8.5 percent less than otherwise would have been the case. (Homeowners had the option of exempting the first $5,400 of assessed valuation if it would have provided greater tax relief than an 8.5 percent credit.)
General property tax relief was possible because of a higher-than-normal balance in the state's general fund, which includes revenues from state sales, individual income, corporate income and miscellaneous taxes. By the end of the 1988-89 fiscal year (June 30, 1989), the general fund balance had reached a record $299 million.

LB 84 sunsets (ends) on July 15, 1990. Provisions for continued property tax relief have not been made beyond that date because of uncertainties about continued state funding.

Commitments already have been made by the Legislature to increase appropriations by $140 million (14.4%) for fiscal 1989-90 and by an additional $69 million (6.2%) for fiscal 1990-91. Additional commitments are likely to be made in the 1990 general session of the Legislature.

Also, there is no assurance that general fund revenues will continue to increase at the rate of the past two years. From fiscal 1986-87 to fiscal 1987-88, revenues increased by $123 million or 13.9 percent. From fiscal 1987-88 to fiscal 1988-89, the increase was $108 million or 10.7 percent.

There are a number of reasons to be cautious about Nebraska's future tax revenues:

- Income tax rates have been reduced slightly in both 1988 and 1989. Thus, a given amount of individual income will generate somewhat less tax revenue than in the immediate past.

- The recent period of economic growth in Nebraska may not continue indefinitely. Thus, there will be, at some time, a leveling off or decline of state revenues. Revenue collections typically follow the economy, both up and down.

- Unresolved matters relating to property taxes in Nebraska also may preclude continued general property tax relief. Some of these issues will be identified in the remainder of this publication. Continued deterioration of the personal property tax base, for example, may necessitate increasing state aid to local units of government, thereby reducing available state funds for general property tax relief.

- Finally, it has not been determined whether citizens and policy makers would support general property tax relief if it meant an increase in sales or income tax rates or extending the sales tax base. The Department of Revenue estimates that a 1 cent increase in the state sales tax (from 4 to 5 cents) would generate an additional $114 million. An increase in the primary individual income tax rate from 3.10 percent to 4.10 percent would bring in about $150 million. A sales tax on services could generate up to $120 million, if applied to a broad range of services. However, political opposition could be expected from those who would not benefit directly from a shift away from property taxes to another revenue source.

Succinctly summarized, the key issues are:

1. Should general property tax relief be continued? If so,
   a. For how long?
   b. At what level?
2. Can general property tax relief be continued without increasing tax rates at the state level?

3. Compared to other revenue/expenditure concerns of state and local governments in Nebraska, how high a priority should be given to general property tax relief?

The Personal Property Tax Problem

On July 14, 1989, the Nebraska Supreme Court ruled that the personal property taxes levied on two natural gas pipeline companies, Northern Natural Gas Company (a subsidiary of Enron Corporation) and Trailblazer Pipeline Company, violated federal and state constitutional requirements for equal tax treatment.

The pipelines' case (hereafter, the Enron case) stems from 1987 tax relief given to railcar companies and railroads by the federal courts under the Railroad Revitalization and Regulatory Reform Act (in abbreviated form, the 4-R Act). The railcar and railroad companies have been granted personal property tax relief in Nebraska because the federal courts have found that the granting of personal property tax exemptions for "commercial and industrial property as defined in the 4-R Act" discriminates against railcar and railroad companies that do not receive such a benefit.

The Nebraska Supreme Court held in the Enron case that the Equal Protection Clause of the 14th Amendment to the U.S. Constitution is violated when the state, even when acting involuntarily and under compulsion of federal law, undervalues a particular class of property and, in so doing, makes another class of property disproportionately higher. If the railcar and railroad companies are given relief, so should the pipeline companies according to the Court.

The Court also determined that pipeline companies' pipe was personal property. According to the Court, the intent of the parties making the annexation of property (in this case, pipe) to the real estate is the most important factor in determining whether the designated property is personal or real property.

Further, the Court found that the portion of the valuation of the pipeline attributable to the real property was entitled to be equalized with the ratio of unimproved agricultural land. (At the time of the decision, agricultural land had the lowest assessment ratio relative to its market value of any class of real property.)

The Enron case has significant and potentially serious ramifications for all property taxation in Nebraska—and perhaps beyond Nebraska's borders.

While the case involves centrally assessed companies, the relief granted by the court may not be limited to such companies. If one taxpayer is exempted from paying tax on personal property, then might all taxpayers be granted the same relief under the 14th Amendment? If not all personal property is to be exempted, where will the line be drawn? Centrally assessed companies only? Centrally assessed companies plus locally assessed companies with property similar to centrally assessed companies? Could property which heretofore has been classified as real property but now is characterized by its owners as "intended to be personal property" also be exempted?
In August, 1989, over 900 requests were brought to the State Board for property tax relief, with the Enron decision being the primary basis for relief. However, the Board denied all requests. Nearly 250 appeals of the Board's decisions have been made to the Nebraska Supreme Court. Thus, further insights into what the court meant in the Enron case seem certain to be forthcoming.

It is also possible that the State Board could seek to have the Enron case reviewed by the U.S. Supreme Court. However, it is uncertain whether the nation's highest court would be willing to accept the case. It could refuse to accept jurisdiction on the grounds that because the Nebraska Constitution requires taxes to be levied "uniformly and proportionately," any differences in interpretation of the 14th Amendment may not be sufficient to overcome the uniformity clause.

Other states have an interest in referral of the Nebraska case to the U.S. Supreme Court, because a U.S. Supreme Court ruling could help all states by more precisely specifying what is tax discrimination. Traditionally, the high court has ruled that a state legislature needs only some "rational basis" for determining classes of property to be taxed or not taxed.

Nebraska already has granted many exemptions to personal property tax liability over the past two decades (table 1). The total value of exempted personal property is now estimated at $13.5 billion. This compares to $9.2 billion worth of personal property that remains on the tax rolls.

The potential annual loss of revenue to local units of government exceeds $220 million, should the personal property tax base continue to be reduced (table 2). That amount is about 19 percent of all property tax collected in the state.

For many local units of government, loss of revenues from reduced personal property taxes could be devastating. Some jurisdictions already have reached the tax levy lid imposed by state statute. Thus, it may be impossible to make up for lost revenue from personal property taxes by increasing the levy on real property. Even where the levy lid is not an impediment, local officials may be reluctant to increase levies on a property tax base that has been reduced by court-ordered exemptions.

The response to Nebraska's personal property tax crisis has taken several forms. In November, 1989, the Nebraska Legislature met in special session and passed three bills.

The first redefined real property (as contrasted with personal property) to include pipelines, railroad track structures, electrical and telecommunication poles, towers, lines and other items "actually annexed" to property. This approach recognizes that much less real property is exempted from taxation than is the case for personal property. Thus, redefining personal property to make it improved real estate may result in fewer exclusions by the courts on equalization or uniformity grounds.

A second bill specified that refunds for prior years' taxes will be permitted if the courts declare additional parts of the state's personal property tax system unconstitutional. However, only taxpayers who properly pursued their equalization claims and had been successful in court would be entitled to refunds for the years in dispute.
Third, a separate class of exempted personal property was created for railroads and railcar companies. It is hoped that this will be adequate to meet the requirements of the 4-R Act. However, it is not known whether such action will allow other personal property to be taxed, especially centrally-assessed property, without being ruled unconstitutional.

It may be determined that, as a result of the 1989 special session, no further legislative action is necessary or desirable until further directives come from the courts.

However, if further responses are made in the 1990 general session of the Nebraska Legislature, one or more of the following proposals may be implemented:

1. A bill apparently will be introduced to require the state to reimburse local governments for revenue losses incurred because of the removal of personal property from the tax rolls. Obviously, this would require the state to find the necessary revenues from its own sources to make this reimbursement. State expenditures likely would have to be reduced in other areas or taxes increased. (A proposal in the 1989 special session that the personal property tax shortfall be compensated for by an increase in the corporate income tax rate failed to gain approval.)

2. All personal property might be removed from the tax rolls. Some experts have suggested that it might not be necessary for this to include motor vehicles as the latter are in a separate classification at the present time. The tax loss would either be $220 million (including motor vehicles) or $120 million (excluding motor vehicles).

3. All personal property could be placed back on the tax rolls. The objective would be to move toward uniformity and equalization of the tax burden. Undoubtedly, those who are now exempted would be strongly opposed to this approach.

4. All items of personal property could be taxed, except those being held for resale. This would exclude cattle in feedlots, grain in storage and business inventories. However, agricultural equipment would not be exempt, as is the case at the present time. The constitutionality of this approach has not been determined.

5. A designated proportion of all personal property could be exempted from taxation, with the remainder subject to taxation. At the present time about 75 percent of personal property is exempted. This would be relatively revenue netural as a tax on 25 percent of all personal property should raise about the same amount of revenue as the current full tax on 25 percent of all property. However, this proposal also might be subject to a constitutional challenge in the courts.
Table 1.

History of Personal Property Tax Exemptions in Nebraska

<table>
<thead>
<tr>
<th>Year</th>
<th>Action Taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>- State no longer collects property tax revenues.</td>
</tr>
<tr>
<td></td>
<td>(LB 59) - Household goods, clothing and other personal items exempted.</td>
</tr>
<tr>
<td></td>
<td>(LB 144) - Intangible property such as stocks and bonds exempted.</td>
</tr>
<tr>
<td>1970</td>
<td>- Voters approved Constitutional Amendment 10 which allowed the Legislature to classify personal property &quot;as it sees fit.&quot;</td>
</tr>
<tr>
<td>1972 (LB 1241)</td>
<td>- Business inventory, agricultural equipment and machinery, livestock, grain and seed partially exempted.</td>
</tr>
<tr>
<td>1977 (LB 518)</td>
<td>- All LB 1241 property fully exempted.</td>
</tr>
<tr>
<td>1987</td>
<td>- Federal district court rules that Nebraska's property tax violates 4-R Act. Carlines exempted; railroads file similar suit.</td>
</tr>
<tr>
<td>1989</td>
<td>- Nebraska Supreme Court exempts pipeline companies from personal property tax using equal protection clause of U.S. Constitution as basis.</td>
</tr>
</tbody>
</table>

Source: Nebraska Department of Revenue.
Table 2.
Potential Annual Loss of Personal Property
Tax Revenue, Nebraska, 1989

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>State Assessed</strong></td>
<td></td>
</tr>
<tr>
<td>*Railroads</td>
<td>$9.0</td>
</tr>
<tr>
<td>*Railcar lines</td>
<td>4.0</td>
</tr>
<tr>
<td>*Pipelines</td>
<td>9.0</td>
</tr>
<tr>
<td>Long distance phone companies</td>
<td>6.7</td>
</tr>
<tr>
<td>Telephone companies</td>
<td>20.0</td>
</tr>
<tr>
<td>Airlines</td>
<td>2.0</td>
</tr>
<tr>
<td>Other utilities</td>
<td>1.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$52.4</strong></td>
</tr>
<tr>
<td><strong>Locally Assessed</strong></td>
<td></td>
</tr>
<tr>
<td>Business equipment &amp; other</td>
<td>70.0</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td><strong>100.0</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>170.0</strong></td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>$222.4</strong></td>
</tr>
</tbody>
</table>

*Court-ordered exemptions already granted.
Source: Nebraska Department of Revenue.
Financing Public Elementary and Secondary Schools

In 1988, the Nebraska Legislature created the School Finance Review Commission through passage of LB 940. The purpose of the commission has been to investigate and make recommendations about several school finance issues: heavy reliance on property taxes, inequities in tax rates and ability to pay from district to district, and low state tax support for school budgets.

Subsequently, in 1989, LB 611 became law. This law requires that at least $200 million in current school financing be shifted to some other source of revenue, such as the state income tax, by 1991.

Together, these initiatives have brought considerable attention to Nebraska's current structure for financing public elementary and secondary schools. Many citizens believe changes are needed. However, there is much uncertainty about whether fundamental changes in school finance can occur prior to resolving the state's personal property tax crisis. (See previous section.)

Property taxes are high in Nebraska, primarily because school districts must rely on property taxes as the primary means of support. For the 1987-88 school year, 67 percent of the financial support for schools came from local property taxes. This compared to 44 percent nationally.

In contrast, state support for schools in Nebraska amounted to only 24 percent of the total in 1987-88. Nationally, 49 percent of the funding for local schools came from state sources.

The heavy reliance on property taxes does not mean that taxes are "high" in all of the 838 school districts in Nebraska. Because property taxes are a function both of assessed valuation and tax rates, the latter tend to be highest where valuations are lowest—and vice-versa. The largest percentage of districts have levies in the $1.25-$1.50 range. However, in 1988-89 property tax levies for individual school districts ranged from 54 cents to $3.42 per $100 of assessed value. In other words, property assessed at $100,000 in the first district ($.54 tax rate) would have had a tax bill of $540; in the second district ($3.42 tax rate), taxes would have been $3,420 for identically-valued property.

To gain a better appreciation of inequalities in property tax funding for schools, the following examples from the School Finance Review Commission may be instructive (tables 3 and 4).

In the first example, two districts are of similar size and make about the same expenditures per pupil. However, because of differences in the tax (valuation) base, the resulting levies are very different:
Table 3.
Comparison of Tax Levies for Two School Districts of Similar Enrollments and Costs Per Pupil, Nebraska, 1987-88.

<table>
<thead>
<tr>
<th>District</th>
<th>Enrollment</th>
<th>Cost Per Pupil($)</th>
<th>Valuation (million)</th>
<th>Levy</th>
</tr>
</thead>
<tbody>
<tr>
<td>District A</td>
<td>445</td>
<td>3319.78</td>
<td>44.4</td>
<td>2.2431</td>
</tr>
<tr>
<td>District B</td>
<td>449</td>
<td>3698.29</td>
<td>95.2</td>
<td>1.1540</td>
</tr>
</tbody>
</table>

Source: School Finance Review Commission; Nebraska Department of Education.

Moreover, when significant differences in property valuations occur, disparities in funding can occur, even when a school district makes a greater effort to tax itself:

Table 4.

<table>
<thead>
<tr>
<th>District</th>
<th>Enrollment</th>
<th>Valuation Per Pupil($)</th>
<th>Levy</th>
<th>Cost Per Pupil($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>District C</td>
<td>401</td>
<td>255,427</td>
<td>1.4301</td>
<td>4,327</td>
</tr>
<tr>
<td>District D</td>
<td>415</td>
<td>95,870</td>
<td>1.6991</td>
<td>3,362</td>
</tr>
</tbody>
</table>

Source: School Finance Review Commission; Nebraska Department of Education.

While the difference in cost per pupil in Districts C and D should not be viewed as a definitive measure of educational quality, neither can it be ignored. Opportunities for diverse course work, well-equipped laboratories, and certain extra-curricular activities may be substantially limited by the funding available for each pupil.

State aid (financial support) is provided to local school districts in Nebraska on the basis of a formula that has three main components:

- **Foundation aid** is the largest component (72 percent of the total). Its purpose is to provide general property tax relief. It is distributed on a per pupil basis, with higher levels of aid for secondary students.

- **Incentive aid** is the smallest component, representing three percent of the total. It is intended to encourage the hiring of high quality staff by local schools. It is distributed on the basis of the number of teachers in a district and their respective degree levels.

- **Equalization aid** has been the component of particular interest to the School Finance Review Commission. Its purpose is to provide tax equity and equalize educational opportunity in districts with low per pupil property tax valuations. (During the 1980s, valuations per pupil have ranged from less than $50,000 to over $2 million.)
Despite the laudable objective of equalization aid, its effectiveness is limited, in part, because it amounts to only about $33 million, or 3.5 percent, of total school expenditures. When distributed over Nebraska's vast system of school districts, $33 million doesn't amount to much—even in districts with the greatest needs.

Critics argue that the school aid formula itself is flawed. Proposals are being made to reduce the proportion of total dollars distributed as foundation aid and increase the proportion distributed as equalization aid. It's also being suggested that income be included in the determination of a school district's ability to provide educational programs.

The School Finance Review Commission has made the following six-part proposal:

- A rebate of 20% of individual income taxes paid by district residents would be made to each school district. It is hoped that such a rebate would result in as much as a 15-percent reduction in aggregate property taxes as most school districts account for 60-70 percent of the property taxes paid.

- To assure equitable opportunities for students in Nebraska schools, the proportion of funding coming from state government should increase from 24 to 45 percent over time. Reaching the latter goal would mean that state and local sources would have approximately equal responsibility for school financing. (The remaining 10 percent of funding would continue to come from federal and miscellaneous sources.)

- State aid should be increased substantially (perhaps up to $100 million) in the next year or two. When combined with the rebate on property taxes, this proposal would mean that as much as $180 million in new revenues would be required from state sources—income and sales taxes.

- Distribution of equalization aid would be based on the so-called "Kansas Plan." In simplistic terms, the formula would determine a school district's needs, subtract its resources, and designate the remainder as equalization aid.

The district's needs would be based primarily on actual expenditures of school districts of a similar size. Resources available would be determined as follows:

- The district's valuation times a predetermined tax levy (estimated to be about $1.00);

- Twenty percent of the state income tax paid by the patrons of the district; and

- All other accountable receipts except categorical federal aid.

The following example of equalization aid for one school district has been provided by staff of the School Finance Review Commission:
DISTRICT NEED: 450 students @ $4,000 per pupil $1,800,000

DEDUCTIBLE RESOURCES:
1) Valuation: $75 million @ $1.00 $750,000
2) Income tax rebate 350,000
3) Other accountable receipts 250,000
Total $1,350,000

EQUALIZATION AID:
Need $1,800,000
Less deductibles 1,350,000
TOTAL AID $ 450,000

- To assure property tax relief and tax equity, limitations (lids) that are sensitive to local needs and spending levels would be placed on school district budget growth. This, too, borrows from the Kansas plan. Districts with a lower spending history would be allowed a higher percentage of growth than those spending at higher levels.

- Districts spending less than their needs according to the equalization aid formula, would be allowed to place funds in a reserve account until the reserve reaches 20 percent of the budget. At that point, any balances in the reserve exceeding 20 percent would be included as part of the revenue for the following year.

Changes in the method of financing public elementary and secondary education will, of course, require legislative approval. Even though three of the School Finance Review Commission’s 16 members are members of the Legislature, that does not assure a quick acceptance of the proposal. In addition to philosophical differences that may emerge, numerous questions remain to be resolved with respect to operational detail.

1. Revenue issues:
   a) Should distribution of state equalization aid be based on locally determined taxable value, given that assessments may not be uniform from county to county?
   b) Would state appraisals or stringent state adjustments of local assessments be desirable?
   c) If a portion of state income tax revenues are designated for rebate to schools, what revenue source should the state use to make up for the lost revenues?

2. Distribution issues:
   a) Precisely what should be included in the local resources (wealth) portion of the proposed new equalization formula?
b) Given the great diversity of Nebraska's school districts, is the proposed need definition appropriate?

c) Should any increase in state aid to local jurisdictions go to all tax districts, not just school districts?

3. Budget limitation issues:

a) If a limitation on a school district's budget growth is desirable, how should it be determined?

b) Should budget growth be allowed to vary from district to district?

c) Should there be exceptions for cost increases beyond the control of districts?

4. Timing issue:

a) Will it be possible to implement a new school finance plan, given the concern in the state about the personal property tax base?

Agricultural Land Valuation

The valuation of agricultural land for property tax purposes has been controversial for a number of years, but particularly so in the 1980s.

Beginning in 1974, the state of Nebraska issued a manual to county assessors to be used as a guideline in valuing agricultural land. In 1979, a state law was passed to mandate the use of the manual.

The 1974 manual used a method of valuing agricultural land that depended on the earnings capacity of the land. It took into account soil types, current agricultural use, production expenses and ultimately, the net income that might be expected. Net income was then divided by a capitalization rate to determine the valuation for different types of farms.

In a noteworthy 1980 case, the Nebraska Supreme Court upheld the use of this valuation approach (Box Butte County v. State Board of Equalization and Assessment). In the Box Butte decision, the Court implied that in some ways the earnings approach to agricultural land valuation may be preferable to an alternative assessment method that relies on linking assessments to actual market values through an assessment-to-sales price ratio. One concern expressed at that time was that in some areas few "arm's length" sales were made. It was also noted that the prices paid for agricultural land often exceeded its actual value (in a cash-flow sense) to property owners.

It is important to recognize, however, that the Court's primary emphasis in the Box Butte case was in using the earnings approach to produce equalization between counties. This approach, according to the Court, did not produce equalization between classes of property (agricultural, residential, commercial and industrial).
A subsequent case, *Kearney Convention Center, Inc. v. Buffalo County Board of Equalization*, became an important test of valuation equalization among classes of property. The Kearney Convention Center challenged the values set in the 1980 agricultural land manual, which were established on the basis of earnings capacity. In 1984, the Court ruled that while agricultural land in Buffalo County had been assessed at 44 percent of its actual value, the property owned by the Kearney Convention Center had been valued at its actual value. The Court said this was unconstitutional, citing the uniformity clause of the Nebraska Constitution.

Because of the *Kearney Convention Center* decision, the Nebraska Tax Commissioner developed a market-determined agricultural land valuation manual. It was based on a land market analysis in July, 1984. The result was an increase in average land value of 60 percent. Not surprisingly, farmers and ranchers protested.

The Nebraska Legislature was convened in August, 1984 for the purpose of dealing with what was viewed as a developing crisis by many agricultural groups. After brief consideration of other alternatives, the Legislature determined that agricultural land should be placed in a separate class of property. Approval for doing so required a constitutional amendment, which Nebraska’s voters approved by a significant majority (411,868 in favor, 175,546 against) in November, 1984. However, the constitutional amendment did not speak directly to the uniformity clause.

In 1985, the legislature enacted two bills in response to the voters’ approval of the constitutional amendment. The first (LB 30) authorized continued use of the 1980 manual in 1985 so values could be assigned expeditiously for the latter year. The other bill (LB 271) was intended to be the long-term answer to Nebraska’s agricultural land valuation concerns. It placed into law—for the first time—a sophisticated formula for determining (and updating on an annual basis) land values. It was an earnings-based approach, with perhaps its most important feature being a capitalization rate determined by blending interest rates on Federal Land Bank loans and U.S. Treasury securities. The capitalization rate no longer could be set arbitrarily by the Tax Commissioner.

In the passage of LB 271, an implicit assumption was made by the legislature (and most agricultural interests) that the constitutional amendment passed in 1984 provided constitutional authority to classify and value agricultural land on a different basis than other classes of real estate. This assumption was abruptly refuted in the 1987 case of *Banner County, Nebraska v. State Board of Equalization and Assessment*. The *Banner County* case can be summarized briefly as follows:

- The 1984 constitutional amendment did not repeal the uniformity clause of the Nebraska Constitution;

- Because uniformity had not been repealed, Nebraska statutes allowing non-uniform assessment (e.g., LB 271) were suspect; and

- The county boards of equalization—not the State Board—retained the power to determine the actual value of agricultural land for tax purposes.
The response of the Nebraska Legislature, the Tax Commissioner, the State Board and the county boards to the *Banner County* case (and other relevant court cases in the past two years) has been twofold.

First, the entities identified above have recognized that the court is saying that agricultural land must be valued uniformly (with respect to its market value) with other types of property. If agricultural land is valued less than other property, then the former's value must be raised or the latter's reduced.

The formal structure for making this adjustment has been LB 361, approved in the 1989 general session of the Legislature. The new statute requires county boards of equalization and the State Board to "correlate and equalize" the values of all property based on the "actual" or "market value of property in the ordinary course of trade" for 1989 and 1990. The Nebraska Department of Revenue estimated in late October, 1989, that this will result in an average valuation increase of 43 percent for agricultural land in 1989 and another 12-16 percent increase for 1990.

A second measure, also approved by the 1989 Legislature, would move Nebraska in a different direction after 1990. It is a proposed constitutional amendment that, if ratified by Nebraska's voters in 1990, would allow agricultural and horticultural land to "... constitute a separate and distinct class of property for purposes of taxation and may provide for a different method of taxing agricultural land and horticultural land which results in values that are not uniform and proportionate with all other tangible property and franchises, but which results in values that are uniform and proportionate upon all property within the class of agricultural land and horticultural land."

The language in the proposed amendment is what many agricultural interests had hoped to accomplish (and believed had been accomplished) with less specific language in 1984. It remains to be seen whether voters will approve this amendment. And if enacted, there are no assurances it will survive a challenge in the state's courts.

For individual owners of agricultural land, big changes in valuation may or may not mean big changes in taxes levied. It depends on the amount of agricultural land in the taxing district. If a district has virtually all agricultural land (as many rural school districts do), then the increased valuation should mean that the tax levy can go down by an equal amount and still generate the same tax revenue. In other words the property tax bill for each property owner should not change unless it was necessary to increase the valuation of certain types of agricultural land more than others to reach uniformity.

In contrast, if agricultural property is a small part of total property valuation in a tax district, then both the valuation and the taxes owed could go up significantly. The reason is that higher agricultural land valuation will not be significant enough to reduce tax levies by much. Owners of agricultural land in some tax districts could see taxes increase by virtually the same amount as valuations. For example, some owners of agricultural land in Lancaster and Sarpy Counties, two of Nebraska's more urbanized counties, could see their tax bills go up by 50 percent or more in 1989.
It is important to recognize that the impact of higher valuations on taxpayers may vary by type of tax district. For example, every county has some residential, commercial, and industrial property in the tax district (county) that would benefit from a shift to a higher proportion of total valuation coming from agricultural land. However, as implied earlier, most rural school districts in Nebraska have only one type of property. Therefore, shifts in the tax burden for supporting the local school cannot occur through valuation changes.

Nebraska's market-based uniform valuation of agricultural land puts it in the distinct minority of states. The majority of states do not include agricultural land prices as a determining factor in valuation. As a result, agricultural land is often valued lower relative to its market value than other types of real property. In other cases, agricultural land may have a relatively high valuation, but tax obligations are moderated by income tax credits for school property taxes or school levy limits on agricultural land. At the present time, Nebraska has neither of these provisions.

The move away from market-based agricultural land valuations in other states has been the result of several factors:

- Property wealth, as represented by the market value of agricultural land, often is not a good indicator of disposable income. Stated more directly, annual property tax obligations generally must come from the income stream, not from selling off a portion of the property.

- It is sometimes argued that property taxes should only be used to support property-related services, such as police and fire protection. Human services, such as education might more appropriately be funded by other revenue sources that better reflect the incidence of benefits received. It may take a great deal of agricultural property to support a farm or ranch family. Many other families own little or no property but have similar needs for schools. Families on the land, it is argued, should not have to support a disproportionate share of the school district's cost out of their income.

- In some states, high property taxes could cause agricultural land to be converted to other uses, such as residential and industrial development. Thus, preferential tax assessment is given to preserve open space.

- Genuine concern, even sympathy, often exists for the financial well-being of those in production agriculture. A political decision, therefore, is sometimes made to grant tax relief to those who own agricultural land.

In 1987 Nebraska's effective tax rate on agricultural land was the third highest among all states. Only Michigan and Wisconsin had higher nominal tax rates, but in both states property tax obligations were moderated by income tax credits. Moreover, both the average rate and Nebraska's relative ranking among the states may increase in 1989-90 as the result of adjustments made necessary by LB 361.

In the future, the total burden borne by property taxes on agricultural land will depend on several factors:

1. Will the Constitutional Amendment relating to non-uniform valuation of agricultural land be approved by Nebraska's voters in 1990?
2. If the Constitutional Amendment is approved, will it be sustained by the Nebraska Supreme Court?

3. Can the personal property tax dilemma be resolved? If not, will it increase the need to raise revenue from all real property, including agricultural land?

4. Will general property tax relief (e.g., as in LB 84) be continued beyond 1989?

5. Will a new school finance law be approved that reduces the proportion of school funding coming from property taxes?

6. Longer-term, will school reorganization move some agricultural land from low-levy districts to high-levy districts?

Concluding Thoughts

Nebraska's property tax dilemma is multi-dimensional. It won't be solved quickly or without difficulty. Personal property owners, especially owners of business property, have one priority; agricultural land owners have another priority; and homeowners have yet a third priority. Users of property tax revenues--school districts, counties, cities, etc.--want to have their say as well.

Simplistically, one could argue that Nebraska property taxes ought to be reduced to no more than the national average, measured either on a per capita basis or relative to personal income. But making the argument ignores the reality of getting there. Fundamental questions remain to be answered.

Nebraskans must collectively ask themselves whether they're willing to continue to generate an ever-increasing amount of revenue from an ever-decreasing property tax base. Would it be preferable to broaden the property tax base so that rates on all taxable property could be more modest? Or would it be even better to generate more revenue from other tax sources, presumably at the state level, so that the amount of revenue needed from local property taxes could be reduced?

Control of local government affairs traditionally has been important to citizens of our state. It's often presumed that increased state funding for local units of government would result in more state direction, if not state control. Is this presumption accurate? Is it appropriate? Are there trade-offs that could make it acceptable for all sides?

Finally, one cannot ignore the political implications of making changes in Nebraska's property tax system. Major changes would have been made long ago if there were not those who would be adversely affected by those changes, at least in the short run. Can Nebraska's citizens be mobilized for a major change in the tax structure even if it means an increase in state sales or income taxes? Should a change in tax structure be associated with a shift in organizational structure for local units of government? Are elected leaders at the state level willing to increase state-imposed taxes, even if voters do not perceive a connection between (presumed) lower local property taxes and higher sales and income taxes?
Careful thought and informed discussion is needed on each of these questions. To the extent that happens, Nebraskans will be closer to finding an overall solution to the specific property tax issues identified in this publication.
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