A System Out of Balance: Property Taxation Across Rhode Island

RIPEC

Executive Summary
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Rhode Island's municipal governments are fundamental to its political system, providing to Rhode Islanders both the most direct form of political representation and key public services. Rhode Island's local governments relied on property tax revenues for 60.4 percent of all local revenues in fiscal year (FY) 2019, far more than any other stream of revenue. Moreover, the state relies on property tax revenues to a greater extent than the country as a whole.

The practice of property taxation has changed significantly in the United States over time. Three historical trends are of note:

1. Reliance on property tax revenues has fallen as sources of government revenue have become more diverse, yet it remains the largest source of local revenue across the country.

2. The type of property subject to taxation has shifted over time. Property taxes once encompassed all forms of physical property, including real property (unmovable land and buildings) and transportable property, also known as tangible personal property. States largely have moved away from the taxation of household tangible property but most (42) continue to levy tangible property tax on businesses. Unlike taxes on real property, tangible personal property taxes are often self-reported and consequently place a unique administrative burden on both businesses and municipal tax administrators.

3. The proportion of the property tax base comprised of residential property increased in the latter half of the 20th century as the American economy shifted from a manufacturing to service-based economy. In result, many state and local governments have enacted policies aimed at homeowner tax relief. State and local governments began limiting allowable property tax revenue growth with policies like levy caps, while also enacting policies such as homestead exemptions and classification ratios that shift the property tax burden away from homeowners and toward businesses and, often, toward renters. Researchers have noted that these policies do not take into consideration a taxpayer's ability to pay, disincentivize business investment, and negatively impact the development of affordable housing.

In Rhode Island, state law both enables the taxation of property at the local level and dictates some of its features, including when assessments must occur, certain types of exemptions, and the maximum year-over-year rate at which the property tax levy may increase. However, Rhode

Island's cities and towns have a good deal of flexibility in terms of how they operate their property tax systems. One area where that flexibility is apparent is in the classification of different property types (residential, commercial, tangible, and motor vehicle) and the application of different rates among classes. The state has a classification plan that cities and towns may adopt by local ordinance, and that limits rate differences among classes such that no effective tax rate for any one class—excluding motor vehicles—can be more than 50 percent greater than the effective tax rate applied to another class. However, over half of Rhode Island's cities and towns (26) have been authorized by state law to follow a different classification structure, thereby allowing several municipalities to tax one property type at rates far exceeding 50 percent greater than the effective tax rate applied to another class of property.

Cities and towns also have been authorized by state law to confer property tax exemptions, including homestead exemptions for residential property and tangible tax exemptions applied to a portion of assessed value. Nine municipalities have homestead exemptions that either apply the full property tax rate to a discounted percentage of a resident homeowner's assessed value, or, in the case of Central Falls, apply a reduced rate to the full assessed value of property. Nine municipalities apply exemptions on tangible property under a certain assessment threshold. Tangible tax exemptions seek to relieve small businesses of part of their tax burden, but they are also a recognition by municipalities that most of their tangible tax levy comes from a few large payers.

An analysis of the revenue sources, assessed property values, property tax rates, and property tax levies of each of Rhode Island's 39 cities and towns reveals wide variance across the state:

- While property taxes comprised over three-quarters of all revenues in nine municipalities in FY 2019, they made up less than half of total revenues in four cities: Central Falls, Woonsocket, Pawtucket, and Providence. Of these cities, all but Providence had greater reliance on state and federal education aid than on property taxes.

- Rhode Island's per capita gross assessed property value (essentially total property wealth per resident) was $120,716 in FY 2019, but while seven municipalities exceeded $250,000 in this metric, the four municipalities with the least property wealth—Central Falls, Woonsocket, Pawtucket, and Providence—each had gross assessed value per capita under $66,000.

- For FY 2022, commercial property was taxed at a higher rate than residential property in 20 of 39 municipalities and tangible property was taxed at a higher rate than residential property in 23 municipalities and at a higher rate than commercial real estate in 19 municipalities. Fifteen municipalities applied the same rate across each class of property. Of the communities with a single tax rate, all but three had per capita gross assessed property values that were higher than that of the state overall. Communities with more property wealth also tend to have lower tax rates across all classes of property. Of the cities with the four lowest per capita assessed values—Central Falls, Woonsocket, Pawtucket, and Providence—all but Pawtucket (ranked 23rd) had among the top five highest residential rates in the state. These cities also had among the six highest commercial rates in the state and ranked in the top eight for highest tangible tax rates.

- Property tax levy per capita for FY 2022 highlights the strong correlation between property wealth and property tax revenues. Central Falls, Woonsocket, and Pawtucket are in the bottom three for both gross assessed value and levy per capita, even though all three cities tax property at a relatively high rate.

The wide variance in property wealth in Rhode Island combined with policy decisions produces highly divergent tax burdens for resident homeowners, nonresident homeowners, and businesses across the state. The tax burden for resident homeowners with $319,000 in assessed value in FY 2022 ranged from $1,927 in Little Compton to $7,337 in West Warwick. In the nine municipalities with homestead exemptions, moreover, the difference between the tax burden for resident and nonresident homeowners can be stark. Providence—which has the state's most generous homeowner exemption—had a resident homeowner tax burden of $4,701 on a property valued at $319,000 (ranked 30th highest in Rhode Island), while its nonresident homeowner tax burden of $7,835 was the highest in the state. The Rhode Island median tax burden for businesses with $1 million in assessed real estate value and $200,000 in assessed tangible property value for FY 2022 was $19,440, but the tax burden ranged widely (by over $35,000) across the state. The municipalities with the lowest tax burden for both businesses and residential property owners were those with the highest property wealth in the state. However, while those with the greatest tax burden for businesses have relatively low property wealth, those with the greatest tax burden for resident homeowners range the spectrum in terms of property wealth.

Rhode Island's property tax systems are out of balance, raising serious questions as to the overall equity and adequacy of education funding, and hindering economic development and affordable housing. Most fundamentally, this imbalance results from the inherent wide disparities in property wealth among municipalities. The inbalance is also caused and exacerbated by policy choices to favor owners of residential properties, particularly resident homeowners, and to disfavor businesses and renters.

Given these findings, RIPEC offers the following considerations for state and local policymakers:

- **State policymakers should consider how the state's education funding formula may be reformed to better respond to disparities in property wealth.** The state's education funding formula already factors in student poverty and community property wealth, and has increased the proportion of state funding for less affluent communities, but simply has not adequately accounted for the lack of property wealth and the limitations on raising property taxes in less affluent urban communities. State policymakers should consider how the state's education funding formula may be reformed to better respond to inequities in property wealth across the state.

- **Municipalities should seek to minimize the use and impact of property tax classification and homestead exemptions.** In shifting the tax burden towards renters and businesses, these policies raise troubling equity issues and hinder both economic development and affordable housing solutions. State policymakers should consider guiderails to narrow the differences between tax rates of different classes and to limit the differential tax treatment between resident and nonresident homeowners.

- **The state should promote tangible reform, reducing municipal reliance on tangible property tax collections.** State policymakers should not only pass broad assessed value tangible exemption enabling legislation, but should require that some relatively low level of tangible assessed value be made exempt from taxation across municipalities. This exemption should be made available to all taxpayers regardless of the size of the tax bill. Over the long term, policymakers should consider means of phasing out the tangible property tax altogether, perhaps by pairing increased exemptions with lower rate caps over time, similar to the motor vehicle tax phaseout. The state's total tangible levy comprises a relatively small portion of the property tax levy (8.1 percent in FY 2022) and some foregone municipal revenues potentially could be recouped through reform of the state's public service corporation tax on the tangible personal property of utility companies.

This report is the second in a series on municipal finance and, as with the first report in the series, includes figures available on RIPEC's website that allow for user interaction and manipulation. The data dashboard that corresponds with this report is available here.