



Current Report

PUBLISHED BY OKLAHOMA STATE UNIVERSITY
DISTRIBUTED THROUGH COUNTY EXTENSION OFFICES

MODIFYING THE PROPERTY TAX SYSTEM IN OKLAHOMA

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Within the past year, a State Supreme Court ruling and the implementation of a Constitutional amendment passed in 1972 have thrown the property tax system in Oklahoma into a state of flux. The purposes of this report are to summarize the operation of the property tax system, to describe the events that have created the current situation, and to examine the tasks ahead.

Present Property Tax System in Oklahoma

In order to fully appreciate the causes and consequences of proposed changes in the property tax system of Oklahoma, it is necessary to understand the general operation of the system and to become familiar with some technical terms. The heart of the property tax system in Oklahoma is the County Assessor. The Assessor is responsible for the annual preparation of the tax rolls. Upon completion of the assessment lists by the Assessor, they are approved by the County Equalization Board and sent to the Oklahoma Tax Commission and the State Board of Equalization for approval. They are then returned to the Assessor and excise board who are responsible for determining the amount of tax due on each property. The completed tax rolls are presented to the County Treasurer for collection.

The County Assessor performs two basic functions: appraisal and assessment. Appraisal means the determination of the value of property. Prior to 1972, the value that assessors were to appraise was the market value of property--the price that the property would receive in a fair sale. Market values are relatively easy to determine for most property. Prices received at auction sales and sale prices of comparable properties are frequently used to estimate or appraise market value.

In 1972, the Constitution of Oklahoma was changed such that the basis for appraising property shifted from the market value concept, to a use value basis. Use value is the value of property in its potential use. Perhaps an example will make this difference a bit clearer. Consider a quarter section

of land near an urban center that has a major highway on one side. At the present time, the land is in wheat. Because the property is ideally situated for a shopping center, the owner of the land has been offered as much as \$4,000 per acre for the land. Therefore, the market value of the land is at least \$4,000 per acre. When property taxes were based on market values, this property would have been appraised at \$4,000 per acre even though similar wheat land in more remote portions of the country was currently selling for as little as \$400 per acre. Land that has value only for use as wheat land, is used to determine the use value of wheat land. Therefore, the use value of every acre of wheat land (of equal quality) in the county would be \$400 such that all wheat land, regardless of its proximity to urban areas, would pay the same amount of tax. The market value of wheat land in the county varies between \$400 and \$4,000 per acre but the use value is a constant \$400. Under the market value approach in this example, some wheat land would pay ten times as much tax as other land equally suited for wheat production, simply because of its location. County Assessors must appraise the value of all property at least every five years to make sure that increased values are fully reflected on the tax rolls. The process of continually updating the values on assessment rolls is called revaluation.

Assessment. Once the County Assessor has determined the appraised value of a parcel of property, it must be placed on the assessment rolls at no more than 35% of its appraised value. In practice, each individual assessor will assess property in a slightly different manner. Usually the assessor will fix an assessment ratio at a level that will generate adequate tax revenues in the coming year, and place all property on the assessment rolls using that rate. For instance, assume an assessor uses an assessment ratio of 15% of appraised value. Then land appraised as having a use value of \$400 per acre would

be placed on the assessment rolls at its assessed value of \$60 (\$400 x 15%). The selection of the assessment rate is very important because it is the easiest element in the property tax system to adjust if additional tax revenue is needed. In practice, the average assessment ratio (often called a sales-assessment ratio when it refers to market value appraisals) varies widely among Oklahoma counties and among different classes of property (rural, urban, etc.) within counties.

Taxation. Once the County Assessor has prepared the assessment rolls showing the total assessed value of all property in the county, the County Board of Equalization meets to hear any complaints from property owners concerning assessments, and to establish the millage rates that will be charged in the coming year.¹ A mill is a tax of \$1.00 per \$1,000 of assessed value. If the County Excise Board sets a total millage rate of 87, then the taxpayers in the district will pay \$87 for each \$1,000 of assessed value on the assessment rolls.

Theoretically, the County Excise Board should determine the revenue to be derived from the property tax by adjusting millage rates to suit the needs of common schools, county government and other program financed by the local property tax. But in practice, state law establishes maximum millages that may be levied and almost every district levies the maximum. The two most important millage limits are 10 mills for general county government, and 39 mills for operating expenses of common schools. Due to the millage limits, the only manner in which a county that is already charging 39 mills can generate additional revenue for common schools is to increase the tax base on which that 39 mills is collected. As we noted before, this may be accomplished by increasing the assessment ratio. Thus, the appraisal technique (market or use value) and the assessment ratio are the two main factors that most influence the tax liability of property owners in Oklahoma.

Equalization. The assessment rolls of each county are sent to the State Board of Equalization after they have been approved by the individual County Boards of Equalization. The State Board of Equalization is given the Constitutional responsibility of determining that property throughout the state has been assessed at approximately the same rate. That is, the Board must certify that the ratio between use value and assessed value is about the same for each county. If the State Board of Equalization finds that it is not, then it may adjust the assessment ratio of the errant counties by increasing or

¹Technically, the millage rate is set by the County Excise Board. The Excise Board and the Equalization Board share the same membership.

decreasing the assessed values of each parcel of property on the county's rolls by a constant percentage factor. This is called equalization--the equalizing of the assessment rates among counties.

After the State Board of Equalization approves the tax rolls, they are returned to the County Assessor who then prepares the tax rolls showing the assessed value, millage rate and tax due for each property. The tax rolls are turned over to the County Treasurer for collection.

Current Situation

In April, 1975, the State Supreme Court ruled that the State Board of Equalization had not performed its duty as required by the Constitution. The duty of the Board is to equalize the assessments between counties such that the assessed value of \$10,000 worth of use value is approximately the same in all counties of the state. For many years, the State Board of Equalization has chosen not to adjust the assessment roll of any county. By 1970, the last year in which the Oklahoma Tax Commission officially measured assessment ratios, property in some counties was assessed at a rate as high as 24% of its market value while in other counties, the assessment rate was as low as 7-1/2%.

Why is equalization important? A basic answer lies in the formula used to determine state aid for common schools. If a school district levies the full 39 mills allowed by law (and most do), then the district is eligible to receive additional support from state funds to bring the total resources available per student up to a minimum level. If the full 39 mills is levied, then the costs of common schools are paid for by a combination of local property tax revenue and state support coming from the general fund. A district with low local support receives high state support, and vice versa. Obviously, there are strong incentives to reduce local support. But the only way that this can be done is by reducing the total assessed value of property in the district causing the average assessment ratio to fall. In other words, in those districts or counties with low assessment ratios, the state is paying a greater share of the common school budget at the expense of taxpayers in all other counties. To be certain that taxpayers in each district pay their fair share and that no schools have less than the minimum level of financial support irrespective of the wealth of the district, it is necessary to equalize assessments among all counties.

After the ruling of the Supreme Court in early 1975, the State Board of Equalization met and instructed the Oklahoma Tax Commission (OTC) to prepare a ratio study. The purpose of such

a study is to determine the average assessment ratio presently being used in each county such that the Board of Equalization will know for which counties and by how much the assessments should be increased or decreased to create statewide equalization. Since most counties have not yet completed revaluations based on the use value concept, the OTC replied that it would be almost impossible to complete a ratio study at the present time which would comply with the Constitutional requirement of use value appraisal.

To summarize, the Supreme Court has told the State Board of Equalization to perform its duties, but the Board cannot equalize assessments without knowing what the appraised value of property is in each county. The appraised use value has not been determined in most counties because of uncertainty surrounding the exact manner in which use values are to be determined. Thus, there are two problems that must be resolved: 1) a complete reappraisal of the state on a use value basis and, 2) an equalization of assessments based on use value appraisals.

Current Issues

There are two basic issues that are before the leaders of the State at the present time: use value appraisal and equalization. While it is impossible to predict what the eventual outcome of the present uncertainty will be, it is useful to explore some of the issues and alternative solutions that have been proposed.

Use Value Appraisal.² Many County Assessors have delayed initiating a use value reappraisal until some guidelines concerning this assessment procedure are developed by either the OTC or the State Legislature. Under pressure by the State Board of Equalization, the OTC is now preparing such guidelines. There are many unresolved issues that will have to be worked out by the OTC before the Assessors can begin to appraise on a consistent use value basis. Several of these are discussed in the following paragraphs.

Which use should determine use value? For example, there is a genuine problem of defining the use value of land that is presently idle. Is its use value zero? What is the use value of a vacant lot in a subdivision? What is the use value of fallow wheat land? For non-agricultural land, one technique for determining use value is to assume that use value and market value are the same. For agricultural land,

²Use value appraisal is often termed "use value assessment." This is unfortunate because it tends to obscure the two individual processes that are involved in the determination of assessed values: appraisal and assessment.

one approach is to assume that the soil type of agricultural land determines its use potential. The better the soil type for agricultural land, the higher the use value. All agricultural land of a given soil type could be appraised at the same rate even if the property were within city limits, so long as it remained in agricultural use.

There are two alternative techniques for determining the use value of specific soil types. One approach is to use the lowest market price at which land of a given soil type last traded as the use value of that soil type. This means that use value is equal to the market value of land that has little value other than for agricultural use. Obviously agricultural land that is near highways and urban centers will have a higher market value than its use value. By taking the lowest sales price as use value, a common floor is established such that use value is equal to market value only for the most remote land of a given soil quality.

A second technique for measuring the use value of agricultural land is the so-called capitalization approach. This approach presumes that the use value of land is equal to the discounted value of all future income streams that can be expected from its present use. To compute use value using the capitalization approach, it is necessary to determine the average annual rental income that is associated with each given soil type, and then capitalize that income by an appropriate capitalization rate. This approach is very difficult to implement in an equitable manner because of the imprecise and arbitrary nature of income and capitalization rate estimates. For example, assume that the best soil type is estimated to have an annual rental value of \$20 per acre per year for agricultural use. If the capitalization rate is chosen as 5%, then the use value of the property is $\$20 \div 0.05$ or \$400 per acre. A capitalization rate of 10% would reduce the use value estimate to \$200 per acre. Hence, very small changes in the capitalization rate can produce rather substantial adjustments in use value appraisals.

One of these two methods will be used to determine the use value of the best soil type in each county. The use value for all other soil types will be taken as a percentage of this figure based on the relative productivities of the soil types. Such an approach implicitly assumes that relative productivities of soil types are a linear function of rental values. Moreover, as relative prices for wheat and cattle shift, the use values of crop and pasture land should also shift accordingly; but, it is quite likely that any system of use value appraisal will not be responsive to these long term price changes.

Equalization. The State Board of Equal-

zation has announced that in November, 1975, they will take the first steps toward equalization of assessment ratios among the counties. It is the intention of the Board to gradually equalize, over a five year period, in order to avoid any drastic shocks to the counties that are significantly below or above the target level. The State Board of Equalization has requested that each County Assessor classify all property into one of four categories: agricultural, residential, commercial and other. Most observers believe the Board is considering a system of differential assessment ratios

by use category. In the past, no such classification has been used. The Constitution explicitly allows different categories of property to be assessed at different rates, so long as the rates are uniform (equalized) among counties. To implement such a program, the Board may equalize assessments rates across the state at one level for agricultural property, and at another for residential, commercial and other property. By using differential assessment ratios, the Board could equalize assessments without placing undue stress on agricultural property.