Texas' Property Tax Puzzle

Charles E. Gilliland and Lynn D. Krebs
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Concerns about persistently increasing property tax burdens, especially on homeowners, have dominated the Texas legislature over the current and past two sessions. While property values have risen steadily, most tax entities grew their budgets even more by raising rates prior to 2019, when the legislature curbed the growth rate of Texas property taxes.

Despite the legislative change, concerns of seemingly ever-increasing property taxes persist. Currently, an unprecedented state budget surplus, largely driven by sales tax revenues, provides the legislature a unique opportunity to take another bite out of property taxes. The challenge is to do this without creating economic distortions related to real estate and other taxable property.

Takeaway

Texas citizens have been clamoring for property tax relief. In California, Proposition 13 was supposed to keep taxes down by limiting appraisal growth rates, but the results have been far from beneficial. Texans can learn from the changes California made and what ultimately went wrong.

Property Taxes and Public School Funding: A Brief History

Beginning in the 1970s, a series of lawsuits challenging Texas state public school financing produced a system that inexorably links Texas property tax policy with school funding issues. Lacking public support for a personal income tax to equalize available resources across school districts, the Texas Legislature came to rely on local property taxes to meet those needs. This dependence dramatically inflated tax burdens for Texas property owners. Effective tax rates increased from approximately 1 percent of market value in the early 1980s to rates exceeding 3 percent in some areas of the state.

In addition to rate increases, administrative reorganization created a single appraisal district in each county except for Randall and Potter, which share a single district. That move necessitated a comprehensive overhaul of the entire property tax system.

Because home values tend to increase more rapidly than those of other property types, this new system shifted a growing proportion of total property taxes to homeowners. Frequent reappraisals caused sizable increases in taxes as rising values, coupled with steady or rising tax rates, increased tax liabilities.

To counteract that tendency, the legislature crafted a number of measures designed to soften rising tax burdens. Concentrating the efforts on homeowners, various measures addressed the problem on three fronts. First, to ease homeowners' tax burdens, various measures exempt part or all of the taxable value of qualified homes. Second, to cushion homeowners from unanticipated tax increases, appraised value increases were limited to 10 percent each year for qualified homes. Third, so-called "truth in taxation" provisions created a process to empower taxpayers to roll back proposed tax rate increases by taxing units.

In 2019, Senate Bill 2 and House Bill 1 changed "rollback tax rate" to "voter-approved tax rate" and lowered that rate from 8 percent to 3.5 percent for cities and counties and 2.5 percent for school districts. The change also came with a requirement for cities to hold automatic elections to approve tax rates exceeding the voter-approved tax rate.

The rollback rule came with some exceptions. It did not apply to special taxing units, such as groundwater conservation districts, junior college districts, and hospital districts. Also, cities with populations of less than 30,000 are not subject to the automatic election requirement. Additionally, a city may add its "unused increment rate" to the annual 3.5 percent limit on maintenance and operations increases.

How Texas Tax Rates Measure Up Nationally

Despite these measures, property tax increases have propelled Texas 2020 effective tax rates for homeowners to the sixth highest in the nation according to research published by the Tax Foundation, indicating a substantial property tax burden for Texans compared with other states (Table 1).

Texas sales tax rates were also among the highest, ranking 14th nationally as of 2023 according to the Tax Foundation (taxfoundation.org/2023-sales-taxes/).

Another Tax Foundation report analyzes the overall burden of state and local taxes for each state (Table 2). In this study, the Tax Foundation defines "a state's tax

Table 1. Effective Property Tax Rates

Rank	State or District	Effective Rate
1	New Jersey	2.21%
2	Illinois	2.05%
3	New Hampshire	1.96%
4	Vermont	1.82%
5	Connecticut	1.76%
6	Texas	1.66%
7	Wisconsin	1.63%
8	Nebraska	1.61%
9	Ohio	1.58%
10	Iowa	1.50%
11	Pennsylvania	1.49%
12	Rhode Island	1.43%
13	New York	1.38%
14	Michigan	1.38%
15	Kansas	1.32%
16	Maine	1.25%
17	South Dakota	1.18%
18	Massachusetts	1.14%
19	Minnesota	1.10%
20	Maryland	1.04%
21	Alaska	1.02%
22	Missouri	0.99%
23	North Dakota	0.95%
24	Oregon	0.94%
25	Georgia	0.91%
26	Florida	0.91%
27	Oklahoma	0.88%
28	Washington	0.88%
29	Virginia	0.87%
30	Indiana	0.84%
31	North Carolina	0.82%
32	Kentucky	0.82%
33	Montana	0.75%
34	California	0.73%
35	Idaho	0.70%
36	Tennessee	0.68%
37	New Mexico	0.66%
38	Mississippi	0.65%
39	Arizona	0.65%
40	Arkansas	0.64%
41	District of Columbia	0.61%
42	Nevada	0.60%
43	Delaware	0.59%
44	Utah	0.59%
45	Wyoming	0.56%
46	South Carolina	0.56%
47	West Virginia	0.55%
48	Colorado	0.54%
49	Louisiana	0.54%
50	Alabama	0.39%
51	Hawaii	0.31%

Source: Tax Foundation

burden as state and local taxes paid by a state's residents divided by that state's share of net national product" (Tax Foundation, Page 3, "State and Local Tax Burdens, Calendar Year 2022," April 7, 2022). Texas ranks sixth lowest among the 50 states and District of Columbia with an overall 8.6 percent effective state and local total tax rate. That amounts to 45.9 percent below New York, the highest state at 15.9 percent. Texas' burden is well below the average of 10.6 percent (Pennsylvania) and the median burden of 10.2 percent (Arkansas and New Mexico).

Texas has consistently ranked among the lowest six states in this study over the last several years, though it declined from third place in 2020. However, the state's burden in 2020 was 8.7 percent, a tick higher than in 2022. Texas' effective state and local tax burden, as measured by this study, has been as high as 8.9 percent (1977) and as low as 7.7 percent (1980), but has been remarkably consistent in a range of 8.2 percent to 8.7 percent since 2010.

Relief Efforts . . . and Results

Despite Texas' relatively low overall tax burden, the effective property tax rate of $1.66 per $100 of value indicated in Table 1 continues to prompt outcries from taxpayers for further relief. This in turn has some lawmakers casting about for a measure that would provide significant tax relief through more restrictive caps on appraisal increases.

An appraisal increase limit of 5 percent was recently proposed in the Texas House. However, the intended benefit of such a cap could be undone, at least partially, by higher rates set by cities and counties across the state, as would be permissible to maintain their budgetary needs, even with existing budget growth limits (see analysis later in this article).

Furthermore, caps on assessed values spawn several market distortions and inequities. For example, it creates a disincentive to mobility and investment and disadvantages for newer real estate buyers, including homeowners. The longer one owns a property subject to an assessment cap, the greater the benefit (and incentive to stay put without making improvements that could trigger a reassessment). Additionally, new entrants to the market, even neighbors to existing owners, would face a disproportionate share of the local tax burden. Finally, other (non-capped) classifications of property would increasingly be subject to rising effective rates.

Similar pressures in California inspired the famous

Table 2. State and Local Tax Burdens by State, Calendar Year 2022

State	Effective Tax Rate	Rank
Alabama	9.8%	20
Alaska	4.6%	1
Arizona	9.5%	15
Arkansas	10.2%	26
California	13.5%	46
Colorado	9.7%	19
Connecticut	15.4%	49
Delaware	12.4%	42
District of Columbia	12.0%	(39)
Florida	9.1%	11
Georgia	8.9%	8
Hawaii	14.1%	48
Idaho	10.7%	29
Illinois	12.9%	44
Indiana	9.3%	14
Iowa	11.2%	34
Kansas	11.2%	33
Kentucky	9.6%	17
Louisiana	9.1%	12
Maine	12.4%	41
Maryland	11.3%	35
Massachusetts	11.5%	37
Michigan	8.6%	5
Minnesota	12.1%	39
Mississippi	9.8%	21
Missouri	9.3%	13
Montana	10.5%	27
Nebraska	11.5%	38
Nevada	9.6%	18
New Hampshire	9.6%	16
New Jersey	13.2%	45
New Mexico	10.2%	25
New York	15.9%	50
North Carolina	9.9%	23
North Dakota	8.8%	7
Ohio	10.0%	24
Oklahoma	9.0%	10
Oregon	10.8%	31
Pennsylvania	10.6%	28
Rhode Island	11.4%	36
South Carolina	8.9%	9
South Dakota	8.4%	4
Tennessee	7.6%	3
Texas	8.6%	6
Utah	12.1%	40
Vermont	13.6%	47
Virginia	12.5%	43
Washington	10.7%	30
West Virginia	9.8%	22
Wisconsin	10.9%	32
Wyoming	7.5%	2

Source: Tax Foundation (taxfoundation.org/publications/state-local-tax-burden-rankings)

Proposition 13 tax measure in the late 1970s, which limited annual increases on appraisals to 2 percent so long as ownership continued in the same hands. This provision led to predictions that assessed values would lag market values in areas with rapidly rising prices. Decades later, circumstances confirmed that forecast. As stated in the report Property Tax Limitations and Mobility: The Lock-in Effect of California's Proposition 13, "longer tenure itself leads to higher subsidies whenever property values increase by more than 2 percent per year," among other issues (nber.org/papers/w11108).

Further unanticipated consequences of the limits continued to roil taxpayers. Newer homebuyers began to notice substantially lower taxes applied to long-term homeowners, with properties of equal market values incurring vastly different tax liabilities. This horizontal inequality tended to inhibit sales by those with longstanding tenure and impose higher taxes on newcomers and younger homeowners. These conditions led a taxpayer to take the matter to the U.S. Supreme Court contending that such a scheme violated the Equal Protection Clause of the U.S. Constitution (*Nordlinger v. Hahn*). The court ruled for the assessor, affirming the Prop 13 limitations. Thus, the unequal treatment of homeowners persists in California.

This history suggests that those advocating tax policy changes should examine anticipated outcomes before adopting particular measures to avoid unintended consequences. A review of economic studies suggests that evaluation of alternative tax policies should consider the following issues:

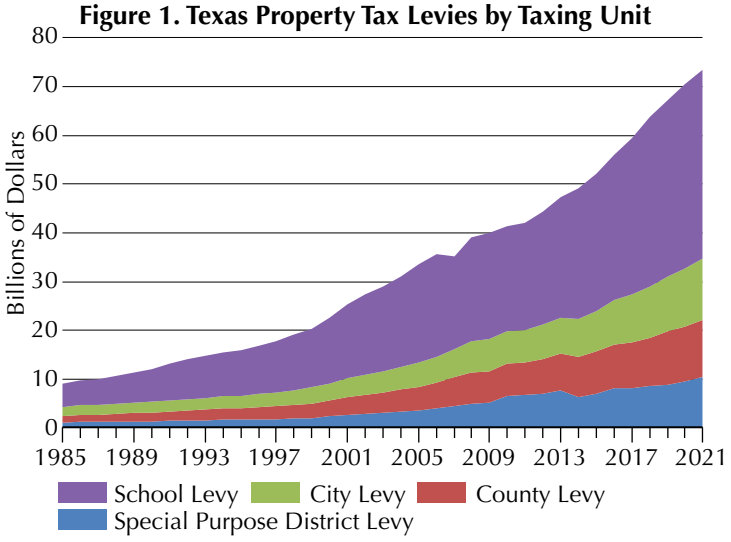
- Will it provide an adequate tax base to support the budgeted activity at an acceptable rate?
- Will the tax inflict a minimal distortion to the signals guiding economic decision-making?
- Will the tax system be readily understandable?
- Will the tax policy be regarded as "fair?"

Scan the QR code to see Texas Real Estate Research Center publication 2037, *Property Taxes: The Bad, The Good, and the Ugly*, for a discussion of these criteria.

Total tax levies by the various taxing entities in Texas from 1985 through 2021 are shown in Figure 1. In 2021, the $38.9 billion school tax levy represented 53 percent of the total, down from 60.3 percent in 2005 and from 54.9 percent in 2013. Obviously, school taxes still compose the major portion of property taxes statewide.

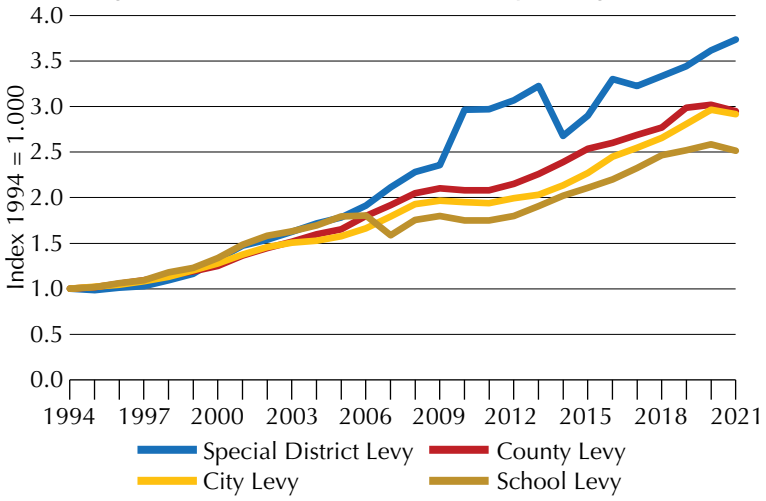
Consider the index of tax levies adjusted for inflation to 1994 dollars (Figure 2). Values greater than one indicate a real increase in tax revenues. At 2.514, school tax levies have more than doubled (approximately 2.5 times) in real terms since 1994. Other units' levies have increased by even more since that time. From 1994 through 2005, school levies increased faster than other units.

Figure 1. Texas Property Tax Levies by Taxing Unit



Source: Texas Comptroller

Figure 2. Trends in Texas Tax Levies by Taxing Unit



Note: Index of Texas deflated tax levies by taxing unit 1994 = 1.0.
Source: Texas Comptroller

Tax relief measures taking hold in 2007 halted that trend. School tax rate compression legislation that passed in 2019 also curbed the increases, whereas the rate growth peaked in 2020 at 2.6 times the 1994 level. The 2021 rate fell just below the 2019 level of 2.521. Special district levies, fueled in part by the addition of numerous groundwater conservation districts after 1997 and not being restrained by the same rate rules that apply to cities, counties, and schools, expanded most rapidly from 2005 to 2013 and then again from 2016 to 2021. Both city and county total levies also expanded rapidly from 2005 through 2008. From 2009 through 2011, levies did not grow for cities, counties, and schools. However, in 2012, cities, counties, and schools began to expand their total levies once more until 2019 (or 2020, when the 2019 legislation took effect).

These expanding numbers reflect the combined influence of local growth and local decisions to provide more revenue to the various taxing units. Some, perhaps a major share, of the expansion of special district levies can be traced to the implementation of statewide water policy provisions in response to regional water planning. Arguably, supporting this planning effort involves prudent outlays designed to provide water for future generations of Texans. Increasing city and county levies reflect individual local governmental decisions to pursue activities requiring local public expenditures. These locally focused actions presumably address concerns of the local citizenry.

Possible Effects of Appraisal Cap Reductions in Texas

The Texas Real Estate Research Center conducted a comparative static analysis of the potential tax shifting effects of proposed property tax reforms envisioned in HB 2 of the 2023 Texas regular legislative session. This included school tax rate compression and a more broadly applied 5 percent appraisal cap. For more details, see Table 5, "Analysis of Shifting Effects of Appraisal Caps for Texas Taxpayers for 2022," in the appendix.

As shown in the appendix, though the school tax rate would be reduced, the proposed appraisal cap would most likely lead to higher tax rates imposed by cities and counties because of the more limited tax base. Applying the new total tax rate to the indicated adjusted taxable values for each property category reveals how the tax burden would shift among properties post reform. Single-family homestead taxpayers would see a 7.8 percent reduction in taxes. Other real estate property (as defined in the appendix) owners would experience a 10.1 percent reduction while personal property and all other property category taxpayers would face a 2 percent increase in property taxes.

However, these estimates do not account for the new construction exempted from the value cap. Adjusting the potential value loss to the 5 percent cap to 80 percent of total in the initial estimates allows an evaluation of the potential effects of new construction in these shifts. Reducing the cap loss would result in a 6.2 percent decrease for single-family homesteads, a nearly 11 percent decrease for other real estate, and a 1.6 percent increase for all other taxpayers.

Expected impacts by property category in the first year:

Single-family residential taxes	-6.2%
Other real property (as defined in appendix) taxes	-10.98%
Personal property and all other property taxes	+1.62%

These estimates illustrate the shifting effects that would accompany the imposition of the 5 percent cap along with a 15-cent tax rate compression. Homeowners and other real estate owners would benefit at the expense of other property owners, including rural landowners, who would see tax increases as well. This is the expected impact in the first year following such a policy change, assuming similar market conditions as 2022. However, as previously explained, the outcomes in the years following will be varied, and impacts on homeowners will vary based on local market conditions and length of ownership. See the appendix for additional analysis assumptions and calculations.

Weighing Merits and Potential Impacts of Reducing Property Taxes

When weighing the merits of proposed policy changes, Texans should keep in mind the criteria of an effective and efficient tax previously listed and the redistributive impact of appraisal caps shown in this analysis.

Currently, some citizens argue that the property tax base as it is configured does not provide adequate funding at a reasonable tax rate. Further restricting tax caps would aggravate that situation. A restrictive cap, such as the one California has adopted, could eventually foster noticeable and growing distortions to the efficient operation of housing markets.

Attempting to reduce tax liabilities by capping appraisal increases multiplies inconsistencies in the tax system over time. Furthermore, appraisal caps do not necessarily reduce tax liabilities proportionately. Although

Californians decided that unequal treatment of homeowners is justified, Texans need to carefully weigh these long-term effects resulting from tightened caps.

In addition to these factors, imposing the cost of supplying public goods on those enjoying them through higher taxes causes taxpayers to weigh cost and benefits before supporting spending measures. Reducing tax burdens for homeowners, arguably the main beneficiaries of local government expenditure, could bias them in favor of more spending because they bear a lesser burden than they would face without the caps.

As the debate over high property tax burdens progresses, Texans should be cautious to avoid even larger problems for the future.

Dr. Gilliland (c-gilliland@tamu.edu) and Dr. Krebs (lkrebs@tamu.edu) are research economists with the Texas Real Estate Research Center at Texas A&M University.

Appendix: Analysis Assumptions

The analysis begins with an estimated distribution of the total 2022 Texas tax levy among the various property types tracked and reported by the Texas Comptroller. Deducting exempt amounts and the losses resulting from the existing 10 percent value cap produces an estimated taxable value for each category of property. Using tax levy reports compiled for the years 2017-21 by the Texas Comptroller provides a basis for estimating the 2022 total property tax levy. Dividing that amount by the total estimated taxable value indicates an average statewide property tax rate of $2.05 per $100 of taxable value. Applying that rate to the estimated taxable values for each property type results in an estimate of the total taxes paid by property owners in those property categories.

Adjusting category taxable values to reflect the effect of a 5 percent cap on value increases and reducing the total levy to reflect the tax reduction envisioned by school tax rate compression of 15 cents accounts for the effects of the proposed measures on the tax levy structure by property class as though the envisioned relief measures had applied to the 2022 tax roll. Those combined calculations result in reduced taxable values for each property type and estimated total 2022 tax levy reduced by an estimate of the compression revenue provided by the state. Using the resulting lower total property tax levy indicates a new statewide average tax rate of $2.09 per $100 of taxable value.

Table 3. Texas Property Tax Values

Category	2022 Value Assigned
A - SINGLE-FAMILY	2,458,256,363,064
B - MULTIFAMILY	321,244,794,793
C1 - VACANT LOTS	76,345,208,310
C2 - COLONIA LOTS	92,780,444
D1 ACRES - QUALIFIED OPEN-SPACE LAND	12,920,460,381
D2 - FARM & RANCH IMP	5,718,826,186
E - NON-AG LAND AND IMPROVEMENTS	161,533,868,073
F1 - COMMERCIAL REAL	634,795,975,876
F2 - INDUSTRIAL REAL	218,806,554,792
G - ALL MINERALS	218,856,526,533
J - ALL UTILITIES	118,610,286,302
L1 - COMMERCIAL PERSONAL	199,165,528,810
L2 - INDUSTRIAL PERSONAL	146,703,758,947
M1 - MOBILE HOMES	12,322,765,332
N - INTANGIBLE PERSONAL PROPERTY	0
O - RESIDENTIAL INVENTORY	17,580,923,339
S - SPECIAL INVENTORY	10,659,370,994
Subtotal	4,613,613,992,176
Less Total Deductions	826,238,496,188
Total Taxable Value	**3,787,375,495,988**

Source: Texas Comptroller

These estimates depend on several assumptions about the Texas property tax system. See Table 3, "Texas Property Tax Values," for the estimated market values of the taxable categories of property. This study assumes the "Value Assigned" in that table represents the total market value for each category of property except for those taxed using assigned values that differ from market values as specified in the Property Tax Code. For example, qualifying open space land tax is based on an "agricultural use" value. Category A shows the situation for single family residential property.

Other real property contains the data for Category B, multifamily; Category C1, vacant lots; Category C2, Colonia lots; Category E, nonagricultural land and improvements; Category F1, commercial real; Category F2, industrial real; and Category M1, mobile homes. Categories D1, open-space land, and D2, farm and ranch improvements, reflect open-space agricultural use value. Special valuation techniques apply to categories O,

Table 4. Property Taxes Reported by Taxing Unit Type, 2020 vs. 2021

	2020 Number of Units	2020 Tax Levy	2020 Percent of Levy	2021 Number of Units	2021 Tax Levy	2021 Percent of Levy	Percent Levy Change from 2020 to 2021
School Districts	1,015	$37,759,657,465	53.56%	1,015	$38,946,142,782	52.96%	3.14%
Cities	1,089	$11,963,476,245	16.97%	1,084	$12,495,940,682	16.99%	4.45%
Counties	254	$11,290,528,493	16.01%	254	$11,694,130,764	15.90%	3.57%
Special Districts	2,063	$9,486,152,671	13.46%	2,092	$10,400,963,921	14.14%	9.64%
Total	**4,421**	**$70,499,814,874**	**100.00%**	**4,445**	**$73,537,178,149**	**100.00%**	**4.31%**

Source: Texas Comptroller

Table 5. Analysis of Shifting Effects of Appraisal Caps for Texas Taxpayers for 2022

	Comptroller Biennial Report and Property Value Study Values and Levy Current Ten Percent Cap on Homesteads	Comptroller Biennial Report and Property Value Study Values and Levy Imposing 5 Percent Cap on Real Property	
Single-Family Market Value	$2,458,256,363,064	$2,458,256,363,064	
Homestead Deductions	$403,381,239,542	$403,381,239,542	
Cap Deduction	$272,659,363,986	$444,549,533,445	
Single-Family Taxable Value	$1,782,215,759,536	$1,610,325,570,077	**Home Tax Shift**
Tax Imposed	**$36,531,743,890**	**$33,675,517,819**	**$(2,856,226,071)**
Other Real Property Market Value	$1,425,141,947,620	$1,425,141,947,620	
Exemptions	$150,197,892,660	$150,197,892,660	
Cap Deduction	$–	$151,602,509,961	
Other Real Property Taxable Value	$1,274,944,054,960	$1,123,341,544,999	**Real Property Tax Shift**
Tax Imposed	**$26,133,721,150**	**$23,491,550,097**	**$(2,642,131,053)**
Total Real Taxable Value	$3,057,159,814,496	$2,733,667,115,076	
Tax Imposed	$62,665,465,040	$57,167,107,917	
Personal Property Taxable	$374,109,582,090	$374,109,582,090	**BBP and Other Tax Shift**
Tax Imposed	**$7,668,474,126**	**$7,823,470,068**	**$154,995,942**
All Other Taxable	$356,106,099,402	$356,106,099,402	
Tax Imposed	$7,299,439,897	$7,446,976,884	**$147,536,987**
Total Taxable Value	**$3,787,375,495,988**	**$3,463,882,796,568**	
Statewide Tax Levy Estimate	**$77,633,379,064**	**$77,633,379,064**	
School Tax Rate Compression	–	$5,195,824,195	
Total Tax Less Compression		**$72,437,554,869**	
Overall Statewide Tax Rate	$0.02049794	$0.02091224	

Note: The column with the 5 percent cap also includes a 15-cent rate compression as proposed in the recent HB 2. The resulting percentage change, without excluding new construction from the cap, are as follows:

- Single family taxes -7.82%
- Other real property taxes -10.11%
- Personal property and all other property +2.02%

Including an estimate of new construction (excluded from the cap) results in the following expected impacts:

- Single family taxes -6.20%
- Other real property taxes -10.98%
- Personal property and all other property +1.62%

Source: Texas Comptroller

residential inventory, and S, special inventory. In addition to those provisions, Texas property tax law exempts Category N, intangible personal property.

The analysis presumes that all existing exemptions and special valuation provisions continue as currently configured. Therefore, exemption deductions and special valuation totals remain unchanged. However, the current 10 percent cap applies only to homesteads. The new cap would apply to all single-family residences and all other taxable real estate.

The market value of single-family residential property increased 28.3 percent from $1.9 trillion to $2.5 trillion in 2022. That total includes new homes as well as value increases for existing homes. A limit of 5 percent growth in aggregate single-family residential value from 2021 to 2022 would result in a reduction of $446 billion in market value. However, the total single-family residential value contains value added for newly constructed homes not covered by the cap. The value for those homes comprises part of the value increase in Category A properties. That value would be an addition to the total that did not result from a reappraisal of existing homes.

In addition, homes that had been subject to the previous cap could have a base well below the 2021 market value. Value loss for those properties would exceed the 5 percent cap reduction in this total. Therefore, the calculated reduction underestimates the reduction attributable to existing beneficiaries and overestimates the loss by the amount of the total new construction. These two circumstances tend to offset each other. The resulting analysis presents an estimate of the direction of tax changes to the property categories. However, the amount of the effects would likely differ from those calculated in the analysis.

Tax levy estimates provided by the Texas Comptroller for 2020 and 2021 appear in Table 4. Analysis of similar reports published by the comptroller for all years from 2016 to 2021 discloses an annual average increase in total taxes of 5.6 percent. Applying that average increase to the 2021 total levy produces an estimated 2022 total of $776 billion for all property taxes in Texas.

Anticipating the effect of a 15-cent tax rate compression requires an application of that rate to the 2022 tax base. Applying that $0.15 per $100 of taxable value for school tax compression indicates a reduction in total required property tax revenue of $5.2 billion, resulting in the estimated statewide tax rate of $2.09 per $100 of taxable value to produce $72.4 billion.

Combining Categories B, C1, C2, E, F1, F2, and M1 (“other real property”) assigned values results in a 2022 total of $1.4 trillion representing a $212.2 billion increase over the 2021 totals. This total includes new construction that would not be affected by the 5 percent limit. Limiting that total increase to 5 percent of 2021 total value produces a value reduction of $151.6 billion, overstating the value loss by the amount resulting from new construction. Deducting existing value loss from exemptions and the estimated 5 percent increase limit loss leaves a taxable value of $1.1 trillion for other real estate.

Combining these loss estimates reduces the 2022 taxable value from $3.8 trillion to $3.5 trillion. Applying the tax compression rate to the reduced total taxable value produces an estimated reduction in the required tax levy from $77.6 billion to $72.4 billion. Raising that amount of revenue using the reduced tax base results in an effective tax rate of $2.09 per $100 of value, a 2 percent increase. Eliminating the tax compression would produce an effective tax rate of 2.241224, or a 9.3 percent increase.

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