



POTENTIAL IMPACTS OF INCREASES IN REAL ESTATE TRANSFER TAXES

A report from the Research Division of the NATIONAL ASSOCIATION OF REALTORS®

© 2003 NATIONAL ASSOCIATION OF REALTORS®. Reproduction, reprinting, or retransmission in any form is prohibited without written permission.

POTENTIAL IMPACTS OF INCREASES IN REAL ESTATE TRANSFER TAXES

In an environment of declining federal aid and limited financing options, local governments are searching for alternative revenue sources. Transfer taxes are no longer only imposed at nominal rates to cover deed-recording costs. State transfer tax rates of one percent or more are imposed in the District of Columbia, Delaware, New Hampshire, New York, Washington, and Pennsylvania.

It is important to consider the issues of equity and economic impact.

- Real estate transfer taxes are regressive because the tax burden is higher for lower income households.
- Real estate transfer taxes are discriminatory because they are assessed against one type of asset – real estate – while similar taxes are rarely applied to financial assets, such as stocks and bonds.
- A household that moves frequently, for whatever reason, does not derive additional benefits or place additional burdens on public services (except for minimal administrative costs) as compared to someone who does not move at all. This violates the principle of horizontal equity, which holds that people who are equal should pay similar taxes.
- The narrow base of property transfer taxes places a larger burden on a small share of the population relative to broader based taxes.
- Transfer taxes are more volatile than apparent.
- Increased closing costs on the transfer of existing residential property are likely to reduce the ability of new and current homebuyers to purchase a home.

A property transfer tax in excess of the costs associated with the administration of property-ownership records is an arbitrary levy that is neither systematically related to a household's ability to pay nor to the benefits that movers derive from public services.

Whether as a general or earmarked revenue source, real estate transfer taxes and fees are a major burden to buyers and sellers, particularly at time of closing. Additionally, these taxes and fees have a negative impact on housing costs and, therefore, economic development. Finally, because of their volatility, these taxes and fees are a particularly poor revenue source for the general operating budgets of state and local governments.

With this in mind, REALTORS® should oppose the establishment of transfer taxes or fees. However, where they currently exist, we urge their repeal; opposition to any increases; and/or the redirection of this revenue source to be used for one-time capital acquisitions that are related to housing or commercial property improvements (e.g. infrastructure).

Background

A real estate transfer tax is a tax assessed on real property when ownership of the property is transferred from one party to another. In some states the tax is also assessed on long-term leases. The tax is typically a certain percentage of the value of the property. Thirty-seven states

Real Estate Transfer Taxes

and the District of Columbia currently provide for this tax. The state statutes may or may not stipulate who (buyer or seller) is responsible for paying the tax. In addition, most statutes list a number of cases where the transfer is exempt from taxation. The National Association of REALTORS® has taken an official policy position in opposition to real estate transfer taxes.

Increased transfer taxes are often earmarked for programs such as low-income housing development and land acquisition for parks and open space.

A property transfer tax in excess of the costs associated with the administration of property-ownership records is an arbitrary levy that is neither systematically related to a household's ability to pay nor to the benefits that movers derive from public services.

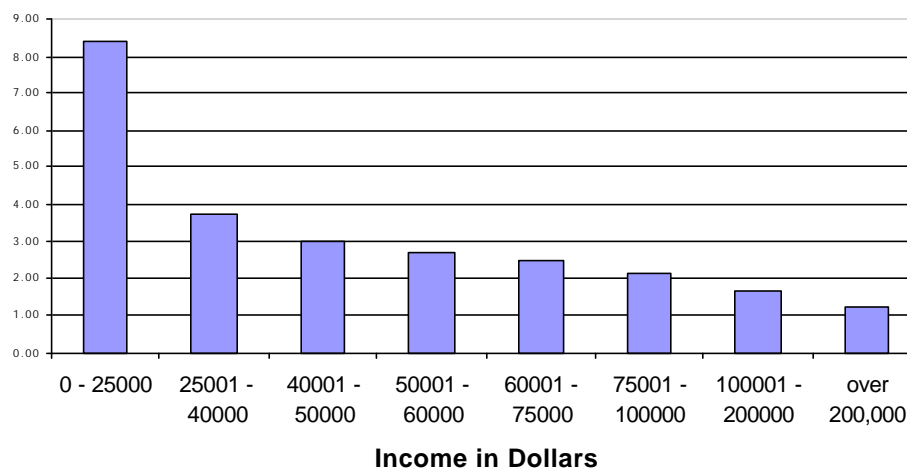
Transfer Taxes are Regressive and Discriminatory

A tax is regressive when its burden relative to income is greater on lower income people compared to higher income people. The property transfer tax clearly falls in the regressive category because people tend to spend a decreasing share of their total income on housing as income increases. Most state and local property transfer taxes are assessed as a uniform percentage of the value of the real property.

The ratio of home value to income for various income levels illustrates this point and is presented in Figure 1. The greater this ratio is, the greater the share of income that is being spent on housing. According to this data on homeowners from the 2001 American Housing Survey, the home value/income ratio drops steadily from a level of 8.4 at an income level of \$12,500 to a ratio of 1.7 at an income of \$150,000. The decline in the home value/income ratio as income increases is why the flat rate property transfer tax is regressive.

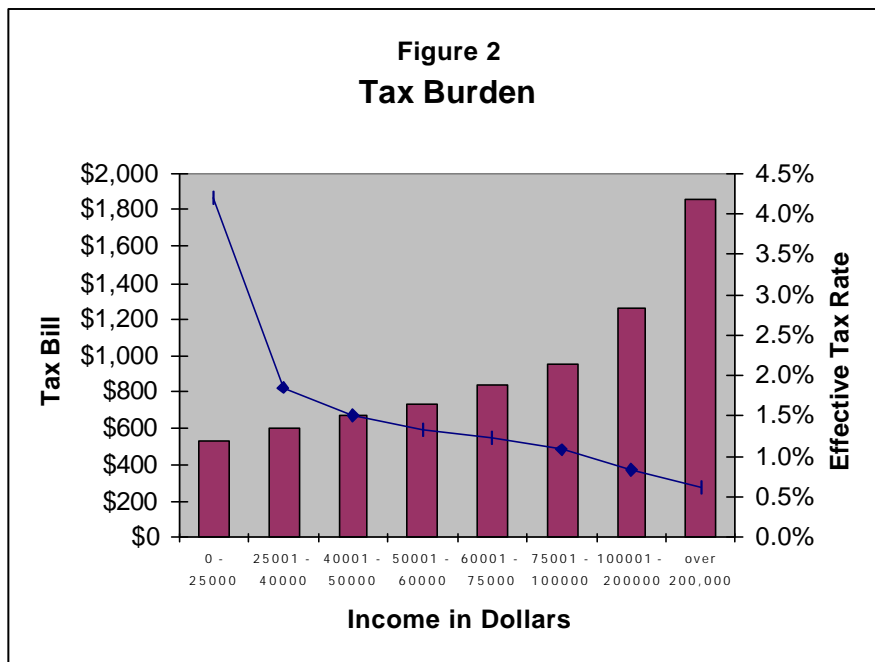
Figure 1

Value to income



Real Estate Transfer Taxes

The degree to which it is regressive is shown in Figure 2. For various income levels and their corresponding average home values, a 0.5 percent property transfer tax is calculated.



The effective property transfer tax is then calculated. The effective tax rate is a relative measure of tax burden that relates taxes paid to ability to pay. In this case the transfer tax was related to income. At an income of \$12,500, the 0.5 percent transfer tax is \$526, which results in an effective tax rate of 4.2 percent. On the other hand, the average person making \$150,000 pays a much higher transfer tax of \$1,264, but relative to income, the effective rate is a much lower 0.8 percent. Therefore, relative to income, the property transfer tax burden decreases as income increases.

The above analysis is for a particular year, but another factor to consider in analyzing the distribution of the transfer tax burden is the frequency with which households buy and move into new homes, and therefore incur the tax, over time. People at higher income levels tend to move slightly more frequently than people at lower income levels. For example, according to the May 2001 Census Geographic Mobility Report, the average \$100,000 income household had lived in their home for an average of 12.5 years. This compared with double that for households making \$12,500. However, even after considering the differences in moving frequency in the burden-distribution analysis, the tax is still highly regressive. The tax burden for the \$12,500 income household is more than double that of the \$100,000 income household who moves twice as much. The effective tax rate for the mobile \$100,000 income household is 2.2 percent compared to 4.2 percent for the \$12,500 income household. Therefore, even adjusting for differences in the frequency that the tax is paid by different income levels, the property transfer tax is still highly regressive.

Another important characteristic of the property transfer tax that contributes to its regressive nature is that it is a tax on only one type of asset, i.e., real estate. Therefore, the property

Real Estate Transfer Taxes

transfer tax discriminates against buying a home versus buying some other type of asset such as stocks or bonds or buying other large ticket consumer durable goods. As can be seen in Table 1., housing equity is larger than stock holdings at the lower income levels. However, as incomes rise, the stock holdings rise more quickly and for the highest income group, stock holdings are larger than housing equity. Thus any tax applied to real estate assets such as housing would be regressive relative to taxes on other assets such as stock holdings.

Table 1.
Assets Held by Income Level: 2001

	Percent Homeowners	Median Value of Housing Equity	Percent Stock Owners	Median Value of Stock Holdings
All Families	67.7	\$52.0	51.9	\$34.3
<i>Percentile of Income</i>				
< 20	40.6	\$37.0	12.4	\$7.0
20 - 39.9	57.3	\$40.0	33.5	\$7.5
40 - 59.9	66.0	\$38.9	52.1	\$15.0
60 - 79.9	81.8	\$54.4	75.7	\$28.5
80 - 89.9	90.9	\$84.4	82.0	\$64.6
90 - 100	94.4	\$166.0	89.6	\$247.7

Source: *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, Federal Reserve Bulletin, vol. 89 (January 2003), pp. 1-32.

This discriminatory nature of the transfer tax adds to its regressivity. Table 2 shows the relationship between the realty transfer tax and total assets. For the average family, a 0.5 percent property transfer tax equals 0.41 percent of the value of all assets. However, as income rises, an increasing share of income is used to purchase assets other than real estate, so the property transfer tax comprises a decreasing share of total assets. Therefore, a 0.5 percent transfer tax represents less than half the tax burden of the median family – only 0.15 percent of total assets.

Real Estate Transfer Taxes

Table 2.
Real Estate Transfer Tax Burden

	Value of Total Assets	Value of Primary Residence	Property Transfer Tax: 0.5%	Tax as a % of Total Assets
All Families	\$147,400	\$122,000	\$610	0.41%
<i>Percentile of Income</i>				
Less than 20	\$24,900	\$65,000	\$325	1.31%
20 - 39.9	\$67,200	\$80,000	\$400	0.60%
40 - 59.9	\$115,000	\$95,000	\$475	0.41%
60 - 79.9	\$230,000	\$130,000	\$650	0.28%
80 - 89.9	\$377,100	\$175,000	\$875	0.23%
90 - 100	\$1,009,400	\$300,000	\$1,500	0.15%

Source: *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001*

Survey of Consumer Finances, Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, Federal Reserve Bulletin, vol. 89 (January 2003), pp. 1-32.

Narrow vs. Broad Based Taxes

One of the disadvantages of the property transfer tax is that it is a very narrowly based tax. It is a tax on a single item – the value of property when ownership is transferred from one party to another.

One problem with a narrowly based tax is that the burden of paying the tax falls on only a small percentage of residents of a jurisdiction. The number of housing units that are transferred in a single year can change dramatically from year to year. The implications of distributing the tax burden through the property transfer tax or through broad-based taxes can be illustrated by comparing the tax burdens that a typical household would incur under various alternative taxes designed to raise identical amounts of revenue.

Replacing the transfer tax with an increase in a broad-based property tax would mean that a homebuyer would not face a high one-time payment at purchase, but would pay a higher property tax each year they owned real estate. If the transfer tax was replaced by a broad-based tax, over an extended period of time, people who move frequently would pay less in taxes and people who live in one house for a long time would pay more in taxes. Therefore, the key factor as to whether a particular household ends up paying more over time under a transfer tax compared to a broad-based property tax is the frequency with which they purchase a new home. If a sales or income tax were used, then the tax base would increase further and renters would share the burden, decreasing the tax required from homeowners.

Real Estate Transfer Taxes

Volatility of Revenues

Residential real estate is characterized by strong cycles. Home sales volume declined by 50 percent from the late 1970s to early 1980s. In early 1990s, sales again fell by 20 percent. Thus, real estate services would not provide a stable source of revenue if history were our guide.

Transfer of Existing Property

The real estate transfer tax can have a direct impact on the costs of transactions involving existing housing and other real estate. While there is no research on closing costs that would allow us to conduct a precise measurement of the effect of new taxes on real estate transaction, we can provide a stylized example that can approximate the effect. For a home costing \$125,000, a moderately priced home, a new or increased transfer tax of 0.5 percent would increase the cash needed at settlement by \$625 – an increase of 5.7 percent over estimated closing costs of \$10,909.¹ A transfer tax of 1 percent faced by homebuyers in six states would impose a tax of \$1,250 on this moderately price home and burden the homebuyer with an additional 11.4 percent in closing costs.

Increases of this magnitude are likely to impact the ability of new and current homebuyers to purchase a home. An increase of \$625 in the purchase could prevent 203,000 households across the United States from purchasing a home each year. This impact would be doubled at the higher tax rate. This impact is not spread evenly across the country. These additional fees could decrease the number of homebuyers each year in selected states.

States	Households Affected	2002 Home Sales	% Decline in Home Sales
California	14,200	696,000	2.0%
Florida	11,800	578,100	2.0%
Maine	1,000	39,300	2.5%
New York	11,200	191,100	5.9%
Texas	16,000	593,100	2.7%
Virginia	3,700	160,400	2.3%

This increased cost of purchasing a home results in a decline in mobility that is likely to create a negative spiral in tax revenues. Higher transfer taxes discourage mobility among current homeowners and discourage frequent movers from entering homeownership. With fewer households moving, the revenue generated from the transfer tax is not likely to meet expectations based on current mobility rates. If the lower tax yield leads to increases in the transfer tax rate, mobility could decline again, repeating the cycle.

¹ Based on rates from Bankrate.com and NAR calculations.

Real Estate Transfer Taxes

Conclusion

State and local governments are searching for alternative revenue sources. Raising the real estate transfer tax is being considered in several states. A property transfer tax in excess of the costs associated with the administration of property-ownership records is an arbitrary levy that is not related to a household's ability to pay or to the benefits that movers derive from public services. Real estate transfer taxes and fees are a major burden to buyers and sellers, particularly at time of closing. As a result, these taxes have a negative impact on housing purchases and therefore economic development. Real estate transfer taxes are a poor choice for local governments because the volatility of the revenue stream makes the funding unreliable and because the regressivity of the tax places an unfair burden on lower income homebuyers and those who move frequently.

REALTORS® should oppose the establishment of transfer taxes or fees. Where they currently exist, we urge their repeal, opposition to any increases, and/or the redirection of this revenue source to be used for one-time capital acquisitions that are related to housing or commercial property improvements (e.g. infrastructure).

Sources:

Analysis of State and Local Real Estate Transfer Taxes, Price Waterhouse Washington National Tax Service, August 1988, Prepared for the National Association of REALTORS®.

Property Taxes, Mobility, and Home Ownership by Arthur O'Sullivan, Terri A. Sexton, and Seven M. Sheffrin, *Journal of Urban Economics* 37, pp. 107-29, 1995.

Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001, Survey of Consumer Finances, Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, *Federal Reserve Bulletin*, vol. 89 (January 2003), pp. 1-32.