

CITY OF BALTIMORE

STEPHANIE RAWLINGS-BLAKE, Mayor



DEPARTMENT OF LAW

GEORGE A. NILSON, City Solicitor
101 City Hall
Baltimore, Maryland 21202

June 20, 2011

Honorable President and Members
of the City Council of Baltimore
Room 409, City Hall
100 N. Holliday Street
Baltimore, Maryland 21202

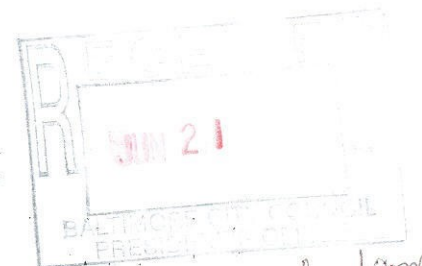
Attn: Karen Randle
Executive Secretary

Re: City Council Bill 11-0668 – Charter Amendment – Property Tax
Limitations

Dear President and City Council Members:

The Law Department has reviewed City Council Bill 11-0668 for form and legal sufficiency. The bill amends Article 1 of the City Charter by adding § 12 Property Tax Limitation. This section would require the City property tax rate to be reduced by at least \$.15 each year for three years, beginning July 1, 2013, for every \$100 of assessed real property valuation. Beginning July 1, 2016, and each taxable year thereafter, the City property tax rate would be limited to no more than \$1.10 for every \$100 of assessed real property valuation. The new section also would permit the City to establish one or more non-lapsing funds for purposes of reducing the City property tax, which would be funded from certain revenue derived from the homestead credit as well as from grants, donations, and money appropriated in the annual Ordinance of Estimates. Unspent money in the fund would remain in the fund until appropriated. Finally, the bill would amend §§ 6 & 7 of Chapter VI of the City Charter with amendments that conform to the new provisions in Article 1 described above.

The Law Department has several concerns with the bill. First, the bill requires that all revenue derived from the homestead credit percentage that exceeds 104 percent be placed into one or more non-lapsing funds for the reduction of the City's property tax rate. Rather than make such action mandatory, the Law Department recommends that the funding requirement be permissive to provide the City a measure of flexibility in funding of its future needs. Our legal concerns with CB 11-068 arise in the bill's definition of property tax and the proposed property tax cap.



Unfair Comments

Definition of Property Tax

Section 12 (A)(1) of CB 11-0668 provides that the term property tax “means the tax levied and imposed ...on all real property in the City of Baltimore.” Section 12(A)(2) excludes certain property from the definition; namely, the term “does not include the tax levied and imposed on personal property or on operating real property, as described in the State Tax – Property Article § 8-109(c).” Section 8-109(c) concerns public utility property.

The quoted language in § 12(A)(2) is ambiguous. It is not clear whether the definition intends to shield just the personal and real property of a public utility from the tax limitation discussed later in the bill; or whether it intends to shield all personal property (i.e., the personal property of individuals, businesses and public utilities) along with the real property of a public utility. Whatever the intent was or may be, State law prohibits these forms of property from being shielded.

The Maryland Court of Appeals has repeatedly ruled that the State’s public general laws prevail whenever a provision in a local charter conflicts with them. Rosecroft Trotting & Pacing v. Prince George’s County, 298 Md. 580 (1984). Maryland’s Tax-Property Article, 6-302(b), requires that the “county tax rate applicable to personal property and the operating real property described in § 8-109(c)...shall be 2.5 times the rate of real property.” The term “county” is “construed to include Baltimore City, unless such construction would be unreasonable.” Annotated Code of Maryland, Article 1, § 14. Consequently, State law prohibits the City from imposing and levying a tax rate on personal property, and on the real property of public utilities, other than the tax rate specified in State law; namely, a rate that is 2.5 times greater than the tax rate established for real property. In other words, the City cannot shield these forms of property from the effect of a local property tax limitation.

Pursuant to the State requirement, the definition of “property tax” in CB 11-0668 must be revised to conform to State law before the Law Department can approve the bill for form and legal sufficiency.

Property Tax Limits

The Court of Appeals has held that property tax limitations are proper charter material in home rule jurisdictions. *See* Board v. Smallwood 327 Md 220 (1992); *see also* Hertelendy v Board of Ed. of Talbot County, 344 Md. 676 (1997). “A limitation of the power of a legislative body to raise revenue is at the heart of the form on structure of our government...” Smallwood, 327 Md. at 238. In Smallwood, the Court considered the validity of proposed charter amendments that attempted to limit property taxes in Anne Arundel and Baltimore Counties. The charter amendments proposed to limit property taxes using both “percentage cap” and “roll back” provisions.

The percentage tax cap provision authorized the county councils to increase property tax revenues by no more than a certain percentage. The Smallwood Court held that the percentage cap limitation did not conflict with the requirements of State law, specifically § 6-302(a) of the Tax-Property Article, that requires county governing bodies annually to set the property tax rate. Smallwood, 327 Md. at 242-43. In effect, the requirements of State law make setting the local property tax rate a legislative act and thus, not an activity controlled by the voters by charter provision. The Court reasoned that the county councils could still exercise reasonable legislative discretion by legislating tax rates that remained below the tax cap. *Id.* For this reason, the “proposed tax limitation would not have the effect of allowing the electorate of the two counties to set the tax rate [by charter amendment].” *Id.*

While the Smallwood Court upheld the percentage limitations, it struck down the “roll back” provisions in the charter proposals. These provisions attempted to limit the amount of property tax revenue collected for the 1991-1992 tax year to no more than the amount collected in the base year of 1989 – 1990 for Baltimore County and the base year of 1988-1989 for Anne Arundel County. “Unlike the tax cap provisions that would have simply placed a limit on the taxing power of each county council, the roll back provisions would have transferred the county councils’ § 6-302(a) powers to the voters. Instead of the councils setting the tax rates, the roll back provisions would have allowed the voters of Baltimore and Anne Arundel Counties to set the property tax rates for the tax year 1991-1992.” *Id.* at 244.

The Court of Appeals struck down a tax cap proposal for the Talbot County Charter for similar reasons. The proposed charter amendment in the Hertelendy case, *supra*, effectively limited the amount of property tax that could be collected annually to the amount that had been collected in the fiscal year 1978-1979, not including newly constructed property or other property not previously assessed. Consequently, any increase in property tax revenue above the amount collected in the 1978-1979 tax year had to be derived entirely from newly constructed property or other property not previously assessed. Hertelendy, 344 Md. at 679.

The Court in Hertelendy reviewed its previous decision in Smallwood and stated that “[t]he teaching of Smallwood is that, although property tax limitations may be valid charter material when they ‘would have simply placed a limit on the taxing power of [a] county council,’ § 6-302(a) of the Tax-Property Article prohibits charter provisions that ‘would have transferred the county councils’ § 6-302(a) powers to the voters’ and ‘would have allowed the voters . . . to set the property tax rates for the tax year’” Hertelendy, 344 Md. at 683 *quoting Smallwood*, 327 Md. at 244. In effect, “a ‘tax cap’ is valid only so long as it confers some authority upon a county council to carry out its mandated duty under § 6-302(a) of the Tax-Property Article.” *Id.* at 685.

Given the above rulings by the Court of Appeals, the Law Department concludes that the tax limitation provisions of Council Bill 11-0668 appear, on their face, lawful. Nonetheless, we are mindful that the tax limitations discussed in the above cases are different than the limitations imposed by CB 11-0668.

The bill establishes a final and fixed property tax rate of \$1.10 which would emerge for the taxable year beginning July 1, 2016 and applies each year thereafter. In contrast, the above cases discuss limitations not on the local *property tax rate*, but on the amount of *property tax revenue* that can be collected in a given year. Furthermore, the tax limitations in those cases permitted a modest increase in the amount of revenue that might be collected from one year to the next. These differences between CB 11-068 and the above cited cases do not appear significant enough to dislodge the Court's overall holding as it may apply to the proposed legislation: a tax cap is valid if it confers some authority on the local governing body to establish the property tax rate, albeit at a rate no greater than the limit imposed by a charter provision. In support of this conclusion, we note that § 812 of the Charter of Prince George's County establishes a cap on the local property tax rate, just as CB 11-068 establishes a cap on the City property tax rate.¹

Accordingly, it is the Law Department's view that City voters may establish by charter amendment constraints on the City's power to tax property. Such provisions may limit the City's property tax rate to a certain dollar amount, as long as the limit allows the City governing body to set the tax rate at or below the specified limit. Furthermore, a charter amendment may require the property tax rate to be reduced by a certain amount for period of time, as proposed by CB 11-0668.

Practical effect may be unlawful

Nonetheless, while the subject of the charter amendment is proper and the methodology it uses to set the tax limit is within the legal parameters set by the Maryland Courts, the Law Department notes that the practical effect of the property tax limitation may be unlawful. As the Smallwood Court concluded, "County governments are required by state law to provide many public services such as public education, police and fire protection services, water and sewage services, etc. If it is subsequently demonstrated in a particular case that a local limitation on property tax revenues so hampers a county government that it cannot perform the duties required under state law, a tax limitation charter provision may well be found to be invalid as applied." Smallwood, 327 Md. at 243-244. *See also* E. McQuillin, The Law of Municipal Corporations at § 44.26 (3rd ed. Revised 2003). This reasoning follows from the Court of Appeals ruling that the State's public general laws prevail whenever a provision in a local charter conflicts with them. Rosecroft Trotting & Pacing, supra.

Some of the services mentioned above by the Court allow for significant budgetary discretion by the City; that is, while the City must provide state mandated services such a police, fire and water and sewer services, the level of services (and thus the ultimate cost of the services) is largely a local issue.

¹ The Prince George's County rate was initially \$2.40 per \$100 of assessed valuation when property was assessed at 40 percent of its true valuation. Since 2000, the county tax cap has been read to mean \$.96 per \$100 of assessed valuation. In passing, we additionally note that besides Prince George's County, Anne Arundel, Baltimore, Montgomery, Talbot and Wicomico Counties have property tax limitations imposed by their charters.

To determine the practical effects of a tax cap bill, the budgetary impact of mandated items over which the City has limited financial control may provide more solid ground on which to launch the analysis. Consider, for example, public schools, the Sheriff's Office and the Office of the State's Attorney. To be sure, the City exercises some discretion in regard to funding these entities, but the City's range of choices in this regard is constrained by State law.² According to the City Budget for FY 2011, the General Fund spending on these three items was estimated to be \$280 million.³

To this (largely) mandated spending can be added spending for which the City is contractually obligated. Given the topic's complexity from both a legal and accounting perspective, it is unlikely that anyone has a firm grasp of the true amount of the City's contractually obligated spending. For the sake of illustration, however, consider a single item: debt service. Debt service pays the interest and principal costs on the bonds issued by the City to build capital projects. It is viewed as required spending because debt often involves pre-existing contractual obligations where outstanding bonds are secured by the supposed unlimited taxing power of the City. Presumably it is for this reason that the Charter permits the City Council to reduce most appropriations except such items as amounts "for the payment of interest and principal of the municipal debt." City Charter, Article VI § 7(a). General Fund spending on debt service in FY 2011 was estimated to be \$115 million.

Given the above amounts of General Fund spending, bear in mind that the property tax limitation in CB11-0668 primarily impacts General Fund spending. The City accounts for all property tax revenue in its General Fund. Summary of Adopted Budget, Fiscal 2011 at 36. More to the point, the General Fund supported \$1.3 billion in spending in FY 2011, of which 55 percent (\$765 million) derived from the property tax. *Id.* Had a tax cap of \$1.10 been in effect for FY 2011, as proposed for FY 2016 and thereafter under CB 11-0668, a rough but reasonable estimate of the maximum property tax revenue that could have been realized is \$371 million.⁴

Compare this tax yield against the total General Fund spending on the four budgetary items discussed above, categories of spending over which the City has limited financial control. The tax yield (\$371 million) covers the three categories of state mandated spending (schools, Sheriff and State's Attorney - \$280 million), but when debt service is added (\$115 million), the four items total \$395 million in General Fund

² For public school budgeting, see Education Article, § 5-102; for budgetary matters involving the Sheriff's Office, see Courts & Judicial Proceedings Article, § 2-309; for budgetary matters involving the State's Attorney, see Article 10, § 40.

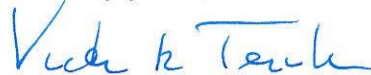
³ City spending from the General Fund for the Baltimore City School System totaled \$238 million (\$200 of which was for Maintenance of Effort). See Summary of Adopted Budget, Fiscal 2011 at 78 & 79. The City provided the Sheriff's Office \$16 million from the General Fund. *Id.* at 242. The State's Attorney received \$26 million from the General Fund. *Id.* at 244.

⁴ The estimated amount is based on the assessable base and property tax yield data reported on page 47, Summary of Adopted Budget, Fiscal 2011.

spending, an amount that exceeds the projected property tax yield under a tax cap. Accordingly, the property tax limit under the proposed bill would not have yielded enough General Fund revenue to cover these non-discretionary budget categories, let alone impact the amount of discretionary spending involving essential services like police, fire and emergency services that are typically and largely funded from the General Fund.⁵

The Law Department is aware that the fiscal impact of the proposed bill is intended to be offset by a proposed increase in the cap on the homestead credit, which is the subject of proposed CB 11-0669. As we understand the proposal, the reduction in the property tax rate is expected to increase home-buying in the City, which will impact on the City's assessable tax base, which will in turn increase property tax yields along with the proposed increase in the homestead credit. These results, however, are expectations, not certainties. If the expectations prove illusory, the above analysis shows that the ability of the City to fund state mandated services likely will be severely hampered by the proposed tax cap. Thus, unless the Department of Finance concludes that such City services will not be jeopardized significantly by the passage of CB 11-068, the Law Department cannot approve the bill for form and legal sufficiency. In addition, the definition of "property tax" must be revised in the manner discussed above.

Sincerely yours,



Victor K. Tervala
Assistant Solicitor

cc: George Nilson, City Solicitor
Angela C. Gibson, Mayor's Legislative Liaison
Elena DiPietro, Chief Solicitor
Hillary Ruley, Assistant Solicitor
Ashlea Brown, Assistant Solicitor

⁵ General Fund spending on Police was estimated at \$317 million, while fire and emergency services was estimated at \$147 million.